THE FUTURE OF SOCIAL SECURITY FOR THIS GENERATION AND THE NEXT: IMPLICATIONS OF RAISING THE RETIREMENT AGE

HEARING

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

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THE FUTURE OF SOCIAL SECURITY FOR THIS GENERATION AND THE NEXT: IMPLICATIONS OF RAISING THE RETIREMENT AGE

THURSDAY, FEBRUARY 26, 1998

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SOCIAL SECURITY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 1:02 p.m., in room B–318, Rayburn House Office Building, Hon. Jim Bunning (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON SOCIAL SECURITY

FOR IMMEDIATE RELEASE CONTACT: (202) 225–9263
February 13, 1998
No. SS–13

Bunning Announces Eighth Hearing in Series on "The Future of Social Security for this Generation and the Next"

Congressman Jim Bunning (R–KY), Chairman, Subcommittee on Social Security of the Committee on Ways and Means, today announced that the Subcommittee will hold the eighth in a series of hearings on "The Future of Social Security for this Generation and the Next." At this hearing, the Subcommittee will examine the implications of raising the retirement age. The hearing will take place on Thursday, February 26, 1998, in room B–318 Rayburn House Office Building, beginning at 1:00 p.m.

In view of the limited time available to hear witnesses, oral testimony will be from invited witnesses only. However, any individual or organization may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

The Subcommittee's first seven hearings in the series have focused on: the recommendations of the Advisory Council on Social Security, the fundamental issues to consider when evaluating reform options, the findings of the 1997 Social Security Board of Trustees, the experiences of other countries, the views of policy experts, organizations with different generational perspectives, business and labor representatives, Members of Congress on Social Security reform, and the current state of public opinion on the future of Social Security.

When major changes were last made to Social Security in 1983, a provision was included that will gradually raise the "normal" retirement age—the age at which one receives unreduced benefits—from age 65 to age 66 over the period 2003 to 2008, and to age 67 from 2022 to 2027. Today, as concern continues about the long-range solvency of Social Security, proposals have been made to increase the "normal" retirement age even further.

A substantial portion of a growing long-range deficit in Social Security financing is being attributed to projections of a decreasing ratio of workers to recipients in the future, especially when the baby-boom generation begins to retire. It has been argued by many that raising the retirement age would offset, at least to some extent, the deficit in Social Security's long-range financing. However, there are many issues surrounding a further increase in the retirement age that require consideration, including: projected life expectancy increases and whether those increases are accompanied by improvements to workers' health, effects on the labor market, the impact on employer-sponsored benefit plans, public reaction to additional increases in the retirement age, and the extent to which savings to the Old-Age and Survivors Trust Fund will be offset by costs to the Disability Insurance Trust Fund, among others.

In announcing the hearing, Chairman Bunning stated: "Raising the normal retirement age is one of those options that may sound simple, when you consider how life expectancies have been rising. However, like so many of the proposed options for Social Security reform, although they may sound easy, in fact, the impacts are wide-spread and significant. Through this hearing, I look forward to fully exploring both the intended and unintended effects of raising the normal retirement age."

FOCUS OF THE HEARING:

The Subcommittee will receive the views of actuaries, social insurance experts, employers, and employee representatives on proposals to raise the normal retirement age. Specifically, Members of the Subcommittee would like to hear from each witness regarding their views on the various proposals to raise the normal retirement age and what they see are the intended and unintended effects.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) single-space legal-size copies of their statement, along with an IBM compatible 3.5-inch diskette in ASCII DOS Text or WordPerfect 5.1 format only, with their name, address, and hearing date noted on a label, by the *close of business*, Thursday, March 12, 1998, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Social Security office, room B-316 Rayburn House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments. At the same time written statements are submitted to the Committee, witnesses are now requested to submit their statements on an IBM compatible 3.5-inch diskette in ASCII DOS Text or WordPerfect 5.1 format. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS__MEANS/'.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–

3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman BUNNING. The Subcommittee will come to order. I'd like to welcome all our guests and those that are going to testify. Today marks our eighth hearing in the series on the Social Security future for this generation and the next. During this hearing, we will focus on the implications of raising the retirement age.

Since our last hearing, Social Security has taken center stage. In his State of the Union Address, the President made a commitment to save Social Security, reserving 100 percent of future budget surpluses until necessary measures have been taken to strengthen the Social Security system. Although clearly sounding as though the Federal budget surplus would somehow be credited to the Social Security Trust Funds, to the contrary, the President's budget proposed nothing new.

There are no new Social Security Trust Fund investment strategies nor any changes to the Social Security taxes or spending. That's why I will introduce legislation which creates a new treasury account, the Protect Social Security Account, into which each year's budget surpluses will be deposited. In essence, my bill would wall off the budget surplus so they could not be spent until a solution to the Social Security is found.

We have a fantastic window of opportunity right now to do what we all need knows to be done. We have to do this; to reform Social Security to make surely it remains solvent beyond the baby boomers; beyond the year 2029, well into the next century. The fact that today we are on the verge of a balanced budget with a potential of significant budget surpluses for the next 10 years gives us a golden window of opportunity to strengthen the Social Security system. We should not let that opportunity pass us.

Today, we examine the reform solution many have discussed: Raising the retirement age. What many Americans may not yet realize, however, is that the normal retirement age, currently age 65, will soon begin to increase beginning in the year 2000. The retirement age will gradually increase over a 22-year period to age 67. We know people are living longer, but we also know that people are choosing to retire early. In 1996, for example, almost three-fourths of those who retired received reduced benefits due to retiring before the age of 65.

Raising the normal retirement age is one of those options that may sound simple, however, like so many of the proposed options for Social Security reform, although they may sound easy, in fact, the impacts are widespread and significant. Additional years of trust fund solvency would be added by providing benefits for fewer years or by reducing workers' benefits even further if they retire before reaching the normal retirement age. However, raising the retirement age would not be advantageous for those who are unemployed or working arduous occupations. Low-wage earners who have poor health or fewer skills would be adversely affected as would certain minority groups with shorter lifespans. More workers age 62 and older probably would continue to work at least part time. Working seniors would be encouraged making greater use of older workers and increasing national productivity. But retirement income might be lower for those who cannot work longer due to employers continuing to provide incentives for older workers to retire and make room for younger workers.

Younger individuals who already will not receive as many benefits from the program as current retirees would see even fewer benefits. Social Security disability program costs probably would be raised as seniors would have an incentive to apply for disability benefits rather than wait to receive full retirement benefits, especially since early retirement benefits would be subject to further reductions. In addition, costs of other disability programs: Workers' compensation, employee pension programs, and unemployment compensation would also likely increase.

More details on these effects and many others will be heard today from the experts who have joined us. I look forward to hearing their views on both the intended and unintended effects of raising the normal retirement age. In the interest of time, it is our practice to dispense with opening statements except from the Ranking Democrat Member. All Members are welcome to submit statements for the record. I yield such time as she may consume to Congresswoman Kennelly for any statement she wishes to make.

Mrs. KENNELLY. Thank you, Mr. Chairman, and I enjoyed listening to your presentation and the legislation that you're going to introduce, and I think it's fine that both of us agree so definitely on what should be done with the—so-called budget surplus.

But I want to welcome the Commissioner here and make a brief statement. With today's hearing, we begin an important year in the discussion of Social Security reform. The President in his State of the Union Address challenged us to save Social Security first. I've recently introduced the legislation along with Ranking Member Charlie Rangel and other Members of the Ways and Means Committee which would implement the President's call. It would do so by creating a Save Social Security First Fund and reserve any budget surplus until action has been taken to strengthen Social Security for the 21st century. In my view, we need to keep old promises before we make new ones.

Raising the Social Security retirement age is among the many proposals made to reduce Social Security outlays. Today's witnesses will lay out for us some of the policy considerations of lifting that age. Some people argue that raising the retirement age makes sense, because life expectancy has increased. Others argue that an increase in the retirement age would fall disproportionately on certain groups of people; for example, the people who are unable to continue working. This might include workers in heavy industry; workers subject to downsizing, and workers in poor health.

We are lucky to have the Commissioner of Social Security with us today and a fine panel of witnesses to share the views that they have with us. I look forward to a full discussion on this issue. I thank you, Mr. Chairman.

Chairman BUNNING. Thank you, Barbara. First, we will hear from the Commissioner of the Social Security Administration, Kenneth Apfel. This is the first time a Commissioner has appeared before this Subcommittee during our hearing series on the future of Social Security. I am very pleased that you could join us and hope you will come back often. Mr. Apfel, would you like to begin?

STATEMENT OF HON. KENNETH S. APFEL, COMMISSIONER, SOCIAL SECURITY ADMINISTRATION

Mr. APFEL. Thank you, Mr. Chairman and Members of the Subcommittee for inviting me here today to discuss the future of Social Security for this generation and the next. I'm especially pleased that the topic of my first hearing as Commissioner for this Subcommittee and in the House is to discuss how to begin to strengthen Social Security for the 21st century. I can think of no issue more important for the country.

As you know, President Clinton has made Social Security reform a top priority. The President proposed in his State of the Union Message that none of the surpluses should be used for tax cuts or additional spending until we address Social Security's long-range financing problem. He said that we must save Social Security first, and the reasons are quite clear. Since its creation in 1935, Social Security has become the most successful domestic government program in the nation's history and our most effective antipoverty program, especially for older Americans. More than 9 of 10 older Americans receive Social Security and about 40 percent are kept out of poverty by their monthly benefit payments.

The importance of retirement income will only grow in the future. Today, there are 34 million older Americans; by 2030, that number will have more than doubled as the 76 million baby boomers move into retirement. At the same time, the growth in the number of senior citizens will outpace the number of workers. Today, there are 3.3 workers for each beneficiary; by 2030, there will only be about 2. These demographic trends have large implications especially for the Social Security Program. These changes will place great strains on America's retirement system and raise serious long-range financial issues. If these issues are not addressed by the United States now, future generations of Americans will not be able to enjoy the same sense of economic security in retirement as have previous generations.

The President wants the American people to become involved in determining the future of this venerable program. He's called for a year-long dialog on the issue of Social Security reform and has challenged every American to become involved. In December of this year, the President will convene a White House conference on the issue, and following that conference, he's called for bipartisan negotiations on long-term Social Security reform. I believe that the President's plan of national discussion and bipartisan political action provides a process for measured yet timely action.

We now stand at the beginning of this process in which the options for reforming Social Security should be discussed, examined, and debated, but any option for change should also be considered within the context of total program reform. By that, I mean that any change in one area, such as retirement age, would affect a degree of change that is practicable or desirable in other areas.

Let me now turn to the specific focus of this hearing: the retirement age. It's a complex issue and raises questions that are indicative of the tough choices facing this Nation. Too few Americans—as you pointed out, Mr. Chairman—are aware that the normal retirement age for Social Security is already scheduled to increase beginning in the year 2000 as a result of the amendments in 1983. Those amendments provided for a gradual increase in the age at which unreduced benefits are first paid from age 65 to 67. The increase will be phased in over a 22-year period.

Now, some individuals propose that the normal retirement age be raised beyond this already scheduled increase or raised faster than is now legislated or tied to increases in longevity. In general, the higher the age you set for full benefits, the greater the effect in improving the program's long-range financial condition, but asking future beneficiaries to work beyond the already legislated age of 67 is clearly imposing a sacrifice on future workers, and the American people have to weigh this option against the other options for improving the financial condition of Social Security.

Let's look at some specific retirement age issues. Those who favor a further increase usually point first to longevity. The life expectancy for a 65-year old in 1940 was 12.5 years and today it is 17.5 years and rising. Proponents of raising the normal retirement age say that if the normal retirement age had been pegged to reflect longevity when the 1983 amendments were passed, the normal retirement age now would be 65 and 10 months today and would reach age 68 in 2054. Had the normal retirement age been pegged to reflect increases in longevity since the program's inception, it would be over 70 today. Proponents also note that there are many indications that the health of older workers is improving. If these gains continue, the period of dependence, or ill health, sometimes associated with old age could be reduced. Improved health could herald longer periods of career productivity and with a declining birth rate, older workers could be in demand in the future.

But others look at the notion of raising the retirement age differently. They say that there is little public support for a higher retirement age. Three out of four workers, today, take reduced Social Security benefits just so they can retire before age 65. Workers in heavy industry would be less able to work additional years because of the physical demands of their jobs, and even some people not working in physically demanding jobs will face pressures. I think of the kindergarten teacher—that's certainly doesn't count as a physically demanding job—but would all 67-year-old kindergarten teachers want to continue to be kindergarten teachers past age 67? I know from my experience, those are tough jobs. They certainly don't count as physically demanding jobs, but they have major workload implications for the individuals who provide that work.

There's a pivotal difference between longer life expectancy and longer healthy life expectancy. A higher, full retirement age would drive up Social Security disability claims to some extent, and I think we'll talk about that today. Some individuals also point to concerns about the impact of raising the retirement age on American business practices. The effect of raising the retirement age on employer behavior would have to be considered. How might businesses change their employment and compensation policies in response to the aging population that wants to work? Will the labor market open up large numbers of jobs to older workers? These are important questions.

Most importantly, we should remember this: While we can evaluate the merit and pitfalls of individual proposals such as increases in the retirement age, the eventual solution to the long-range financing problem will very likely involve many elements in a larger reform package. While we must understand the impact of each of those elements in isolation, we must also recognize that the elements will interact in a context of a broader reform package, and those interactions must be fully understood before any final conclusion can be reached. In the end, we need reforms that strengthen and protect Social Security for the 21st century while maintaining the universality, the fairness, and progressivity of the system.

We're strongly committed to a system that maintains the basic public trust embodied in the Social Security system that provides a benefit that people can count on. The American public needs to understand a number of these complex issues if they are to eventually support reform measures. They need to understand that there are tough choices ahead. No option for resolving the long-term financing problems facing Social Security is perfect. Any proposal for making substantive changes in the current Social Security system, such as raising the retirement age, will need careful study and broad public discussion. The President, of course, has said that he wants just such discussion on the entire subject of Social Security reform throughout this year.

The Social Security Administration will work to educate the public about what Social Security has achieved, how the program works, and the nature of the long-range solvency problem. We're committed to working closely with the Members of this Subcommittee and other Members of Congress in a bipartisan effort to save Social Security first. Thank you, and I'll be happy to answer any questions that you have.

[The prepared statement follows:]

Statement of Hon. Kenneth S. Apfel, Commissioner, Social Security Administration

Thank you for inviting me here today to discuss the "Future of Social Security for this Generation and the Next." I am especially pleased that the topic of my first hearing as Commissioner of Social Security before this Subcommittee, and in the House of Representatives, is to discuss how we begin to strengthen Social Security for the 21st Century. I can think of no issue more important than preserving the program for future generations of Americans. Mr. Chairman, you and Ms. Kennelly have already contributed a great deal of vital information to this important discussion. I commend you for the work you have done by holding this series of hearings.

These hearings will help to make the national debate on the future of Social Security successful and informative. A full and honest discussion of the issues facing Social Security will allow Americans to understand and participate in the decisions that must be made in order to put Social Security on a sound financial footing. I strongly support the President's call for all Americans to be involved in the national dialogue on Social Security in the coming year.

President Clinton's message on Social Security in the State of the Union was clear: Save Social Security first. Our fiscal house is now in order. For the first time in more than a generation, the Nation will enjoy a Federal budget surplus, not only in the coming year, but for many years to come. But the President has also stated that any budget surplus must be reserved pending Social Security reform. He has made it clear that he intends to work with Congress in a bipartisan effort to preserve and strengthen the program.

I am very pleased to be here today to discuss the ramifications of proposals to raise the Social Security retirement age. Today I will review with you the President's process for reform, and in the spirit of that process, try to provide a full overview of the issues that must be addressed when we are asked to evaluate proposals to raise the retirement age.

President's Process

President Clinton wants to use this year to raise the visibility of Social Security reform. He has challenged every American to attend a conference or forum on the issue—or to organize and host one if none are planned in the community. This national call to action must spread to every corner of the country.

The President and Vice President will be actively involved—they will be attending several nonpartisan conferences convened jointly by the Concord Coalition and the AARP on Social Security reform. The first of these will take place on April 7, in Kansas City. They will also be participating in events organized by the Pew Charitable Trust, the first of which will take place March 21.

In December of this year, the President will host a bipartisan White House conference on Social Security as a culmination of the various conferences, forums and discussions held throughout the year. The purpose of the White House conference is to bring together the lessons learned from the national dialogue.

Following the White House conference in December, the President and his team will begin bipartisan negotiations with congressional leaders in early 1999. The President is firmly committed to strengthening Social Security for the 21st Century.

Preserving the Successes of the Program

As we begin this dialogue, we need to reflect on what features have led to Social Security's success. The dialogue will most certainly be about how to address the challenges facing Social Security in the future, but it will also be about how we preserve and protect the accomplishments of the program that has served this nation so well for over sixty years.

First of all, Social Security is dependable. Social Security has been there each and every month. Millions of Americans count on the arrival of their Social Security benefit. Today, more than 90 percent of the elderly in this country receive Social Security. Americans of all ages must be able to count on Social Security in the future. We have an obligation to provide a dependable source of income that Americans can use to plan their financial future with confidence.

In addition, Social Security is efficient. Less than one penny of every dollar collected is used for administering the Social Security program. It is a program that is portable and it is a program that provides benefits that are indexed to inflation.

Social Security is also the greatest anti-poverty program ever created. Without Social Security, nearly 50 percent of today's elderly would be living in poverty. Social Security doesn't make people rich, but it gives Americans rightly deserved financial independence. This financial protection, however, is not just for the elderly. Social security also protects working families through disability and survivors insurance.

Social Security ensures that all workers receive an equitable benefit through a progressive benefit formula. It is a program that is universal and fair. Proportionately larger benefits are provided to lower income workers who will need it most.

Finally, Social Security is a public trust. Social Security spreads the risk associated with disability, premature death, and old age among the entire working population and provides a guaranteed benefit that is adequate and fair.

During this discussion, we would do well to question whether changes to the program preserve and protect these important accomplishments: whether Social Security continues to be a benefit people can count on; whether the elderly, disabled, and survivors of workers are protected from financial hardship; whether the program is efficient; whether the program is universal and fair; and whether the program is maintained as a basic public trust. The dialogue about how we ensure the solvency of Social Security in the 21st century will need to include these critically important questions.

Need for Public Debate

As President Clinton has said, we must inform Americans about Social Security and the issues confronting it. The President's proposal to conduct regional forums to raise public awareness of the problems facing Social Security acknowledges an important truth: the broad-based participation of the American public is critical to achieving a resolution of the long-term solvency issue. An accurate understanding of the facts is needed as the foundation for public discussion. We have been focusing our efforts on educating the public about Social Security programs to put them in the best possible position to be able to enter into public debate about options for the future of Social Security.

Before having discussions about reform proposals, it is important that Americans understand the Social Security program. What do I believe Americans should understand about our Social Security program? What is it about this program that reduced to its essentials makes it of such importance to the American electorate?

I want all Americans to understand what Social Security has meant to older Americans. The plight of older Americans used to be a disgrace. Now, Social Security provides them with a solid measure of economic security even if they outlive the actuarial tables, and their savings. It also provides many of them, and their children, the advantages that only living independently can offer.

I want all Americans to know that Social Security is more than a retirement program. I want younger people to know that not only will Social Security be there for them in the future, it is there for them NOW. How many people know that 1 out of every 3 Social Security beneficiaries is not a retiree but a disabled worker, or a member of his or her family, or a survivor of a worker who has died? They need to know that.

I want all Americans to know that Social Security was never intended to provide for all of a worker's retirement income needs. Pensions and personal savings have always been and should be part of a sound financial retirement plan.

I want all Americans to understand that the changing demographics of the country are the primary driver of the need for change. There is an unalterable dynamic at work: by 2030, there will be nearly twice as many older Americans as there are today, putting great strains on our retirement system.

I want all Americans to understand the economic facts about Social Security. Beginning in 2019, the trust funds will start declining and will be exhausted by 2029, if no changes are made to the current program. After the trust funds are exhausted, however, annual revenues will be able to pay three-quarters of current-law benefits.

Finally, I want all Americans to understand one important fact: as attractive as any option for change might be, there are tradeoffs that must be accepted if we choose it. These are complex issues, and the advantages and disadvantages of each will have to be discussed and examined.

SSA will play a vital role in helping to make understandable the elements that will lead us to long-range solvency. We have made strengthening the public's understanding of the Social Security programs one of our five strategic goals in our recently published Agency Strategic Plan. Through a comprehensive education campaign, Americans will better understand the value of Social Security, while recognizing that its benefits supplement savings, investments, and private pensions in planning for a comfortable retirement.

DEMOGRAPHIC CHANGES

As this Subcommittee is well aware, our population is changing. Americans are living longer and we are having fewer children. The number of older people—those over 65—is climbing. In fact, the population of the elderly, now 34.2 million strong—will more than double by the year 2030, to 69.4 million.

The number of workers collecting Social Security is increasing much faster than the number of workers contributing to Social Security. Today, there are 3.3 covered workers for each beneficiary, but by 2030, there will be only about 2 covered workers per beneficiary.

Now is the time—when the economy is strong, the budget is balanced—to begin to address the economic security for future generations of retirees. Now is the time—when the program is not in crisis—to face the long-range solvency problem and to begin to deal with it. It is important that we address this problem sooner rather than later so that changes can be made gradually and that there will be time for people to adjust their retirement plans.

The President's approach—to use this year for national discussion and debate; to bring our ideas together in a series of forums culminating in a White House conference this coming December—provides an ideal process for measured, yet timely action.

RAISING RETIREMENT AGE

And now to turn to the focus of this hearing: The issue of retirement age, whether it should be raised and how raising it would affect the millions of future retirees who will depend on Social Security, is a perfect example of the complex issues and the tough choices facing us as a Nation.

As you know, the normal retirement age is already scheduled to increase, beginning in the year 2000, as a result of the Social Security Amendments of 1983. Those amendments provided for a gradual increase in the age at which unreduced benefits are first paid from 65 to 67. The increase in the retirement age will be phased in over a 22-year period, with an 11-year hiatus at which the retirement age will remain at 66.

Some have proposed raising both the normal retirement age and the early retirement age beyond what it is under current law. The retirement age changes that are being proposed are intended to help address the long-range solvency problem facing Social Security. Some proposals would raise the full benefit retirement age past age 67 to 68 or even higher. In general, the higher the age is set for full benefits, the greater the effect on improving Social Security's long-range financial condition. Asking future beneficiaries to work beyond age 67 is clearly imposing a sacrifice on these workers, and the American people will have to weigh this option against the other options for improving the financial condition of Social Security.

Another element in some retirement age proposals is the rate at which the increase in the full benefit retirement age is achieved. Some proposals would simply eliminate the present law "hiatus," so that full benefits would still be paid at age 67, but about 11 years sooner than scheduled under current law. Other proposals go beyond age 67 and do so very gradually, or relatively quickly. In general, the faster the higher age is reached, the greater the impact on reducing the Social Security long-range deficit, but the shorter the period that people would have to plan for the new retirement age.

LONGEVITY AND HEALTH

Proponents of raising retirement age tell people that this change makes sense because Americans are living longer. When benefits were first paid in 1935, a 65-year old on average lived about 12.5 more years. Today, a 65-year old could expect to live about 17.5 more years and by 2070, life expectancy at age 65 is projected to be 20.5 years.

Because of the improvements in longevity, some experts argue that it is reasonable to continue to adjust the retirement age to encourage people to work longer. They say it is appropriate for the ratio of years-of-work to years-of-retirement to stay relatively constant from generation to generation. Had the normal retirement age been pegged to reflect increases in longevity when the 1983 Amendments were passed, the normal retirement age would be 65 and ten months today, and would reach 68 in 2054. Had the normal retirement age been pegged to reflect increases in longevity since the program's inception, it would be over 70 today. While it is quite clear that medical and technological breakthroughs have had the effect of extending life spans for many Americans, we do not know what proportion of those extra years are spent in good health and what portion reflects extra years of illness before death. I think we can all agree that, when we talk about raising the retirement age, there is a pivotal difference between longer life expectancy and longer healthy life expectancy.

Some research suggests that the health of older Americans has increased through the 1980s and into the 1990s. Arguments have been made that these gains are likely to continue, and can be expected to have the effect of reducing the period of dependence or ill health sometimes associated with old age, at the same time that life expectancy is increasing. On the other hand, more research is needed to clarify whether gains in longevity and health would mean most workers could extend their worklives. Critics of raising the normal retirement age have pointed out that this could have a disproportionately large impact on older workers in physically demanding jobs. Many analysts suggest that even if the normal retirement age is increased, it may be important to continue to allow early retirement at age 62, with the appropriate actuarial adjustment to benefits, as I will discuss in a moment. While it is expected that there will be fewer physically demanding jobs in the future, these jobs will not disappear. One study released in 1986 looked into the issue of whether people would be able to extend their work careers in the future because of the decline in the number of jobs that would require physical strength and endurance. The study concluded that the proportion of jobs in physically demanding employment will decline slightly from about 11 percent in 1982 to 7–9 percent in 2020.

Another consideration is the effect of raising the retirement age on employer behavior. How might firms' employment and compensation policies change in response to an aging population that wants to work? Older workers often earn higher wages, often accrue more expensive pension rights that a firm must honor, and can increase an employer's health insurance costs. On the other hand, in many respects the older worker is a prized commodity for potential employers. Knowledge, experience, and dependability are characteristics usually associated with the older worker.

Some have raised concerns about whether the labor market can accommodate a steady increase in the supply of older workers. Many experts believe that the U.S. labor market has always expanded to accommodate large, sustained increases in the supply of workers—witness the expansion of jobs for women in the decades after World War II, and the increased employment opportunities that met the baby boomers' entry into the work force. However, as skeptics point out, the continued employment of older workers is not without problems. Skills can obsolesce and health often deteriorates. Firms often have financial incentives to substitute cheaper factors of production, including both younger workers and new equipment. We need to be aware of the potential problems and employment barriers some older workers might face if they attempt to remain in the labor market, as well as the potential contributions they can make.

Another issue is how employer-provided pensions relate to Social Security. If the full benefit retirement age is raised for Social Security, how will this impact on private pension protection? We need to fully examine and discuss the interaction between employer-provided pensions and Social Security.

CHANGES TO EEA

Some have proposed to leave the "earliest eligibility age," or EEA, at age 62 while raising the age at which full benefits are paid. EEA benefits are actuarially reduced to take account of the longer period over which they will be paid. Maintaining EEA at age 62 and raising full retirement age has the effect of stretching the interval over which benefits need to be actuarially adjusted, and the result is that the adjustment in benefits at age 62 would need to be greater to be actuarially fair.

For any given couple, the decision to take a reduced benefit may be reasonable to that couple when they reach age 62. The availability of benefits at 62 may make it possible to travel, pursue hobbies, and, in general, to reap the rewards of retirement. The cost of choosing early retirement, however, is an actuarially reduced benefit throughout their retirement years. Today, almost three out of four workers retire before reaching age 65—electing reduced benefits—showing a strong preference of the American people to retire earlier, rather than later.

RELATIONSHIP BETWEEN RETIREMENT AND DISABILITY PROGRAMS

Many have noted that issues of raising retirement age necessarily include issues of health and ability to work. Raising the retirement age would have repercussions for the disability program. As the normal retirement age increases, there is an increased incentive for workers eligible for early retirement benefits to apply for disability benefits because, unless they are similarly reduced, the disability benefits will be more attractive to older workers.

Opponents of raising retirement age emphasize that some of the savings from raising retirement age would be offset by increased costs under the disability program. Some proposals call for a reduction in disability benefits as a form of early retirement to avoid such an outcome.

Another approach that has been suggested by some would be to make changes in the disability benefits program to take account of those older workers who are unable to extend their work lives for health reasons. This approach was suggested by the Greenspan Commission before the 1983 legislation to gradually raise the retirement age was enacted. As a majority of the Greenspan Commission noted:

"...because some workers, particularly those in physically demanding employment may not benefit from improvements in mortality and be able to work longer, we assume that the disability benefits program will be improved prior to implementation of this recommendation to take account of the special problems of those between age 62 and the normal retirement age who are unable to extend their working careers for health reasons."

While SSA regulations already provide more relaxed eligibility requirements for workers who become disabled after age 55 when vocational factors are taken into account, the question is raised as to whether this is sufficient. There is no easy answer here.

INTERACTIVE NATURE OF INDIVIDUAL ELEMENTS

This complicated relationship between retirement and disability brings me to my final point. That is, we can evaluate proposals as to their individual merits, but the final solution to the long-range solvency problem will very likely involve many elements comprising a larger package. While we must understand the ramifications of each of those elements in isolation, we also must recognize that the elements will interact in the context of the entire package, and that those interactions also must be fully understood before any final conclusions can be drawn.

Conclusion

Raising the normal retirement age involves issues that need to be examined and discussed by all Americans. We must hear from the people, because Social Security is their program.

Every one of us, young and old, needs to understand that there are tough choices ahead of us. No option for resolving the long-term financing problems facing Social Security is perfect, and, as we have seen today in this discussion of raising retirement age, every option involves tough choices.

SSA will continue to take an active role in the process outlined by the President. We will continue to educate the public about Social Security; how it works, what is has achieved, and the nature of the long-range solvency problem. I look forward to working closely with members of this Committee in a bipartisan way to fashion solutions important to this Nation. I will be glad to answer any questions you may have.

Chairman BUNNING. Thank you, Mr. Commissioner. Yesterday, I asked Treasury Deputy Secretary Summers about the President's proposal on Social Security, and as Commissioner of this vital program, I would like to hear your views as well. Would you please explain for me the President's proposal for the treatment of the budget surpluses and reform of Social Security?

Mr. APFEL. The President has strongly suggested that we save Social Security first by reserving the budget surpluses pending Social Security reform and that we use our current budget rules to assure that those surpluses are not drained away through either tax cuts or other spending increases until we address the issue of Social Security reform. I should also indicate that our current budget projections show that the first surpluses will arrive at the end of fiscal year 1999, and it's our belief that we can get this whole issue completed, legislation enacted, before the end of fiscal year 1999, before those first budget surpluses start to come on stream. The President has not specifically proposed that the budget surpluses be provided to the Social Security Trust Fund at this time. We have not at all ruled out the possibility of a whole series of different ways the surpluses could be used to strengthen the Social Security system. But that's really what this year is about, how to assure the long-term future of Social Security and how those surpluses could be used to help strengthen Social Security.

Chairman BUNNING. In other words, in his proposed budget, there is nothing to change the current law as far as taking the FICA taxes and investing them in nonnegotiable bonds and then spending that money. There is nothing—no change.

Mr. APFEL. There is no proposal to do that in this budget. We do not think it's necessary at this time given the fact that the surpluses will be coming on stream in 1999. I would note that you've indicated an interest in legislation to organize a form of an accounting mechanism to assure that those surpluses would be walled off. Mr. Rangel, Mrs. Kennelly, I believe, have a similar approach. We would be open to discussing those with the Congress. At this time, we haven't seen the need for legislation to do that because of our desire to complete action on this in 1999, but we're not at all opposed to discussing whether a specific mechanism, an accounting mechanism, should be created.

Chairman BUNNING. Certain members of the administration have discussed transferring a part of the surplus to the trust funds. In essence, this would mean a huge transfer of general tax receipts into the trust funds. In your view, should any tax receipts be used to fund Social Security? Should taxpayers feel any connection between the taxes they pay and the benefits they receive? And I'm speaking, then, in that tax receipt about FICA tax. The budget surplus is separate. Some members of your administration suggested that we transfer the surplus into the trust funds. I think there has to be a connection between the FICA tax and the benefits.

Mr. APFEL. No members of the administration have proposed that the surpluses be transferred. One of the options that needs to be considered this year—and there's been internal discussion and there will be discussions all year—is this is one option that I think deserves considerations: Whether the surpluses would be transferred in whole or in part in some form to the Social Security Trust Fund. There are other options as well: Whether the surpluses would be invested in equities and provided to the trust fund. Another option that some have proposed is to use the trust fund balances and invest part of those balances in equities; not transferring new moneys into the Social Security Trust Fund, but, in effect, using some of the surpluses in equity investments which would also have the effect of using up part of the surpluses.

Chairman BUNNING. I want to—I don't mean to cut you off, but someone in the administration did suggest that, and it was Deputy Secretary Summers, and he argued with me in testimony yesterday, and before the Senate Finance Committee he said, that maybe when we get to $100 billion in surplus, maybe we could make a massive transfer to the trust funds.

Mr. APFEL. I was at that hearing, sir—also testifying——

Chairman BUNNING. Well, but I'll go get you to the testimony if you'd like, and I don't want to argue about what he said.

Mr. APFEL. One of the hypotheticals would be, if $100 billion were transferred in, what would be the potential effect? But we've been very clear that we have not proposed any one of those solutions, and that's really what part of this debate is all about, sir.

Chairman BUNNING. Barbara.

Mrs. KENNELLY. Thank you, Mr. Chairman. Obviously, raising the retirement age is likely to fall the hardest on those with little or no pension benefits. Less than half of Americans working right now have pension benefits. If the retirement age is raised, what will happen to the half of America that doesn't have pension benefits and then wait longer for their Social Security? I'm sure you've thought about it, and how do you respond?

Mr. APFEL. Well, it is true that about half of all Social Security recipients receive virtually no pension or asset income and are heavily, heavily relying on just Social Security. Any change in the benefit structure will fall most heavily on that group of individuals. A change in the retirement age has the effect of affecting all individuals, particularly those nearing retirement by reducing benefits for everyone at a given age. There are other alternatives, other benefit changes, that need to be weighed and considered with regard to their effect on low-income Americans.

Mrs. KENNELLY. Well, my concern is that an awful lot of those individuals are older, poor women with really very little to fall back on and living literally penny to penny to penny; watching every penny, and this is a concern because they just don't have any other alterative other than to be poor.

Mr. APFEL. Women retire somewhat earlier, which means they have a somewhat deeper reduction in actual values in terms of their benefits from Social Security. They also, because of earnings, receive somewhat lower benefits, and they also, as you know, live considerably longer and, potentially——

Mrs. KENNELLY. And we haven't figured out any way for anybody else to have the baby, so they go in and out of the work force, and therefore have the zero earning years too. Everything's going against them.

Mr. APFEL. So, there are a whole number of issues——

Mrs. KENNELLY. In Social Security.

Mr. APFEL. That's right; that's right. But there's a whole series of issues about women that relate to retirement age and also any of the other proposals that are on the table. It's one of the reasons that we have to look at this change combined with any other changes that can be done in a system to determine how the entire package that is developed in the course of the months ahead will provide the strongest floor of protection in a progressive way for all workers, particularly those with lower incomes.

Mrs. KENNELLY. A lot of things have not changed. Generational relationships with more women working have but we've got a whole new group of single heads of households going into the work force, so we'll have many of the same problems with women who stayed at home.

So, it's a problem that really has to continually be addressed and it's the reason we can't do anything else but address the whole future of the Social Security system, and no matter how erudite you get, you come back to that every time, so I have to mention it every time.

Let me talk about another group. The Heritage Foundation has argued that the African-American men get a very bad deal from Social Security because of their shorter lifespan. In addition, those who oppose raising the retirement age point out that raising the retirement age would disadvantage people who have a shorter life. Now, that's obvious; that's very obvious, but as we do this, we have to keep remembering why we have Social Security, and how do you respond to that?

Mr. APFEL. If I could comment on the Heritage study. The Social Security actuaries developed an analysis of the Heritage study on rates of return and indicated that there were some errors that were made in that study, and I would ask for the record if we could include the Social Security actuaries' response to the study. One of the conclusions was that there are significant negative rates of return which we don't think is correct——

Chairman BUNNING. Without objection, we'll let you put it in, and we also will put the Heritage's report in, so that there's a comparison.

Mr. APFEL [continuing]. And if it's their rebuttal which I heard there was——

Chairman BUNNING. Well, we'll let them put their report in.

Mr. APFEL. Great.

[The information follows:]

February 4, 1998

MEMORANDUM

From: Steve Goss, Deputy Chief Actuary
Social Security Administration

Subject: Problems with "Social Security's Rate of Return", A Report of the Heritage Center for Data Analysis

The analysis by William M. Beach and Gareth G. Davis of the Heritage Foundation attempts to provide an answer to the question "What can Americans expect in future Social Security retirement benefits?" The paper suggests that expected rates of return will decrease substantially in the future and that African Americans do now and will in the future have substantially lower expected rates of return than for the general population. However, the conclusions are highly misleading due to two major errors in methodology, plus a number of incorrect or inappropriate assumptions.

Due to these errors, rates of return for the general population in this study are at substantial variance with those produced for the 1994-6 Advisory Council on Social Security (See Appendix 2 of Volume 1 of the report, pages 219-22). For example, for single men (all races combined) born in 1970 with average earnings, real rates of return are estimated at only 0.47 percent by Heritage, compared with 1.28 percent in the Advisory Council Report.

More importantly, the methods utilized by the authors bias expected rates of return downward to a far greater degree for African Americans than for the general population. This study thus erroneously indicates differences in rates of return by race that are greatly exaggerated. In fact, results from more careful research reflecting actual work histories for workers by race indicate that the non-white population actually enjoys the same or better expected rates of return from Social Security than for the white population. (See Duggan, et. al., "The Returns Paid to Early Social Security Cohorts," *Contemporary Policy Issues*, (October), pp. 1-13.)

<u>Error in Method of Computing Expectation</u>

Expected values indicate the average of all possible outcomes for individuals at a point in time with an uncertain future. Instead, the Heritage study erroneously analyzes a single outcome where an individual is assumed to know how long he or she will live. For persons at each age 22 through 66 in 1997, the authors estimated the remaining life expectancy, i.e., the average number of years of life remaining after 1997. Individuals at each age were then assumed to live for precisely the number of years indicated by this average life expectancy. This approach consistently overestimates the expected number of years of work and consistently underestimates the expected number of years after reaching retirement age. As a result, it grossly underestimates the expected rates of return from Social Security retirement benefits. Moreover, the extent of this bias is greater for workers with lower life expectancy, in particular for African Americans. The error is also greater for younger workers who are far from retirement age in 1997.

To illustrate this error, consider the expected years of work and retirement under the Heritage method in comparison with the true expected years for white and black men based on the 1992 United States Life Tables. Life expectancy at age 20 was 54.3 years for white men and 47.2 years for black men. Assuming both planned to work until retirement at age 65, the Heritage approach would assume 45 work years for each, and 9.3 retirement years for white men but only 2.2 years of retirement for black men.

However, the true expected number of work years for both black and white men must be less than 45, because some will die before reaching age 65. In fact the true expected number of work years (reflecting deaths before 65) is 42.2 years for white men and 39.1 years for black men. Computing, for 20-year-old men the expected number of retirement years after 65 requires both the probability of surviving to 65 and the life expectancy at 65 for those who do survive. For white men age 20, 78.1 percent would expect to survive to 65 at which point they would average an additional 15.5 years of life after 65. Thus, the expected years of life for a 20-year-old white male after reaching 65 would be 12.1 years (= 15.5 X .781). For black men age 20, 60.3 percent would be expected to survive to 65 at which point they would average an additional 13.5 years of life. Their expected retirement years would thus be 8.1 (= 13.5 X .603).

Expected Work and Retirement Years for 20-Year-Old Males in 1997

	Work Years		Retirement Years	
	White Men	Black Men	White Men	Black Men
Heritage Erroneous Method	45	45	9.3	2.2
True Expectation	42.2	39.1	12.1	8.1

Clearly, computed rates of return for retirement benefits using true expectation will be much higher for all men, and, moreover, the difference between rates of return for black and white men will be dramatically smaller, than if the erroneous Heritage method is used. While this is the largest and most fundamental error in the Heritage analysis, a number of additional errors further bias the results.

Error in Not Reflecting Relationship Between Mortality and Income

The authors acknowledge the fact that life expectancy is highly correlated with income, and that their estimates do not reflect this fact. Estimates made by the Office of the Chief Actuary, Social Security Administration indicate that for the general population, about 20 percent of the difference in rates of return between low- and high-income workers is removed by properly reflecting mortality differences by income. However, this correlation would be far more important in comparing rates of return between African Americans and the general population.

The authors note that rates of return would be lower for low-income and higher for high-income workers if adjusted appropriately for mortality at the indicated income level. Average-income workers would presumably have mortality at about the level of the average population, and thus be unaffected by the adjustment. While this is all true for the general population, the African American rates of return would be increased much more for high-income workers, would also increase for average–income workers, and would decline much less for low-income workers. This is true because average income for African Americans is substantially lower than for the general population at this time.

For example, African Americans with earnings equal to the general-population average have much higher-than-average earnings within the African American population. As a result, they must be assumed to have much better mortality than the average for all African Americans. Thus, with proper adjustment of mortality by income level, race differentials in life expectancy would diminish greatly, for individuals at the same income level.

Without appropriate adjustment of mortality by income, race-differentials in rates of return are highly misleading. This is the reason that the Office of the Chief Actuary, Social Security Administration has not as yet developed race-specific money's worth ratios or rates of return.

Additional Errors

The authors of the Heritage study exclude disability benefits and taxes from the analysis, even though the Disability Insurance program represents nearly 15 percent of the Social Security. While including disability would not substantially change the expected rate of return for the general population, it would considerably narrow the rates of return for African Americans versus the general population. This follows from the fact that disability benefits are significantly more likely for African Americans than for the population as a whole.

Because Social Security provides survivor benefits when a worker dies before retirement age, and Heritage omits these benefits, the authors also deducted from taxes a premium intended to cover these benefits. The premium appears to exclude those survivor benefits for a spouse that are payable after the youngest child reaches age 16, i.e., widow(er)s benefits that are payable from age 60 to the end of life. Premiums are also likely to be too low if Heritage used premiums for commercially-available life insurance. Life insurance is sold largely to healthy, higher-income persons who can afford the premium and can qualify as insurable. Including lower-income and uninsurable individuals would boost the premium substantially. Making these changes would increase rates of return from Social Security.

The authors raised tax rates for Social Security starting 2015 by enough to cover future benefit costs, ignoring the fact that the Trust Fund balance projected for that time, 300 percent of annual benefits, would continue to grow as a percent of annual benefits under these conditions. In order to produce a pay-as-you-go financed Social Security program, tax rates would not need to be raised until around 2025, and by less than the authors assumed. The early, too-large increase in tax rates results in rates of return that are estimated to be too low for Social Security.

The authors included a "high-income" worker with earnings at 300 percent of the average wage. In fact, the maximum level of earnings that is taxable and creditable for Social Security benefits is now and will be in the future 240 percent of the average wage (less than 240 percent in years before 1978). It is not clear whether the authors included taxes above this maximum taxable level. If they did, then rates of return for Social Security are estimated to be too low for high-income workers.

Treatment of Minorities Under Social Security — Now and Under Solvency Proposals

Current Situation

- Although there are aged beneficiaries of all races with family income below the poverty line, the poverty rate would be much higher if they did not have Social Security benefits. The proportion of beneficiaries whose incomes would be below the poverty line without Social Security:

All beneficiaries:	54 percent
White beneficiaries:	53 percent
African American beneficiaries:	69 percent
Hispanic beneficiaries:	61 percent

- Aged African Americans and Hispanics are also less likely than whites to receive income from assets and from pensions.

  * While 71 percent of whites receive asset income, only 34 percent of African Americans and 33 percent of Hispanics have similar income.
  * Forty-four percent of whites receive pension income, compared to 28 percent of African Americans and 21 percent of Hispanics.

- Because minority groups are less likely to be covered by private or employer disability and survivor insurance policies, Social Security dependents' and survivors' benefits can be extremely valuable. Few people realize that 42 percent of male workers and 28 percent of female workers will die or become disabled before reaching retirement age.

  * One way to gauge the value of disability benefits is to express them in terms of their value as insurance. For a 27-year old average earner with a family who becomes disabled, the value of subsequent Social Security disability and retirement benefits is $285,000.
  * The value of Social Security survivor benefits for the same worker would be $313,000.

- According to the 1990 census, African Americans comprise 12.1 percent of the U.S. population.

  - * However, almost 18 percent of disabled workers on the rolls are African American.
  - * Further, over 23 percent of young survivor beneficiaries are African Americans.

- The average retirement benefit for:

All beneficiaries:	$720
White beneficiaries:	$732
African American beneficiaries:	$607

Impact of Solvency Proposals on Minorities

- The current Social Security program is race-neutral - that is, people of different races and nationalities in identical situations are treated identically. Nevertheless, the program impacts differently on people of different racial groups because rarely are they in identical situations.

- Solutions to the long-range solvency imbalance in the Social Security program fall into two areas:

  - * Reducing program expenditures (for instance, by changing the benefit formula, increasing the retirement age, or lowering the annual cost-of-living adjustments); or
  - * Increasing revenues (for example, by increasing payroll taxes; increasing income taxes on benefits, and investing the trust funds in securities other than government bonds).

Also, many current proposals would establish mandatory private investment accounts—either as a partial substitute for Social Security or as a supplement to Social Security.

- Little research has been done on the impact of specific proposals on minorities. However, different reform proposals would have differing effects on specific groups, some of which are at greater risk of poverty, such as minorities. Rates of poverty for minority elderly are two to three times higher than for the white population.

- Raising the retirement age could result in severe financial hardship for workers who could not continue to work due to illness, unemployment, or the physical demands of their jobs; a greater percentage of such workers are minority workers rather than whites. In recommending an increase in the normal retirement age to 67, the Greenspan Commission noted in 1983 that:

  " because some workers, particularly those in physically demanding employment may not benefit from improvements in mortality and be able to work longer, we assume that the disability benefits program will be improved prior to implementation of this recommendation [increasing retirement age to 67] to take account of the special problems of those between 62 and the normal retirement age who are unable to extend their working careers for health reasons."

  As noted above, aged African Americans or Hispanics are less likely than whites to receive income from assets or pensions aside from Social Security. Therefore any change in the retirement age (or any other change that reduces benefits) is likely to impact more on minorities than on whites.

- Solvency plans that would further increase the retirement age would have a greater impact on races with a shorter life expectancy than others. The number of years of life expectancy at age 65:

	Male	Female
White	16.2	19.9
African American	14.3	18.3
Hispanic	19.0	22.4
Native American	19.7	24.4
Asian/Pacific Islander	20.7	24.9

- As noted above, African Americans have, on average, a higher likelihood than whites of:

    * becoming disabled before retirement age; or
    * dying and leaving survivors wither before or after retiring.

  Any long-range reform which makes reductions in disability and survivor programs would impact disproportionately on African Americans.

- African Americans are more likely than whites to have lower-than-average lifetime earnings. As a consequence, they are more likely to receive the advantage of the weighted benefit formula that is designed to replace a higher proportion of earnings for low earners than for high earners. This is in part because lower income workers are not able to accumulate savings or generate investment income to the extent that higher earners can. Also, this social adequacy feature of the program assumes that lower earners need to have more of their earnings replaced because they spend a higher proportion of their earnings for basic needs.

    * Any long-range reform proposal that shifts the program away from the social adequacy features and more toward individual equity could disadvantage African Americans and other minorities. Privatization plans that substitute private investment accounts for Social Security benefits move in this direction.

- There is some evidence that low-income workers tend to invest more conservatively than others. To the extent that minorities have low incomes and choose to invest conservatively, solvency plans that depend heavily on the investment returns of private investment accounts could have negative effects on minorities.

RACE, INCOME, LIFE EXPECTANCY, AND SOCIAL SECURITY BENEFITS

- **Social Security is race neutral—individuals who are in identical situations are treated identically.** Nevertheless, the program impacts differently on people of different racial groups because rarely are they in identical situations.

- Factors over which Social Security has no control, such as earnings levels, race, and education, and differences in mortality rates and disability rates, influence the Social Security benefit amounts received by individuals.

- Life expectancy rates at age 65 vary by race and reflect the expected time in retirement.

Years of Life Expectancy at Age 65

	Male	Female
White	15.9	19.5
African American	13.6	17.7
Hispanic	18.7	22.0
Native American	18.0	22.5
Asian/Pacific Islander	18.9	23.0

source: Population Projections of the US by Age, Sex, Race, and Hispanic Origin: 1995-2050, Current Population Reports, p.25-1130

- The chances of receiving retirement benefits are reduced for African Americans because higher mortality rates/shorter life expectancies mean that fewer workers will live long enough to reach retirement.

    * However, as shown by the table above, some minority groups fare significantly better than whites in terms of life expectancy at age 65.

- Disability benefit amounts vary by race. In 1995, white disabled workers were awarded disability benefits averaging $714 a month, while African Americans and others were awarded disability benefits averaging $606 and $537, respectively.

- Disability benefit receipt varies by race also. In 1995, 18 percent of disabled workers in current payment status were African Americans, although this group comprises only 12 percent of the general U.S. population.

    * This difference is most acute at younger ages. As shown below, in 1995, 21 percent of workers awarded disability benefits between ages 30-39 were African American; for awards at ages 60 and over, the percentage drops to 14.6 percent.

Disability Awards by Age and Race, 1995

Age at award	Total	% White	% Black	% Other
Under 30	43,500	70.3	17.5	11.5
30-39	104,100	69.9	21.1	9.6
40-49	148,000	72.2	19.3	8.3
50-54	103,100	73.1	18.6	8.0
55-59	129,200	76.3	18.3	5.3
60+	103,700	80.0	14.6	5.2

- Life expectancy, income and race may affect an individual's need for, and receipt of, Social Security disability and survivors benefits.

- Income varies by race, ethnicity, and education level, as shown below:

Mean Earnings of Workers 18 and Older, 1995

	Not a HS Grad	HS Grad	Some College	Bachelor's Degree	Advanced Degree
White	$14,234	$22,154	$24,349	$37,711	$57,054
Black	$ 9,582	$16,196	$18,011	$26,916	$37,864
H.O. *	$13,068	$18,333	$19,923	$30,602	$45,612

source: tablea-03.txt at www.census.gov

- Hispanic Origin (H.O.) may be any race

- As reflected in the attached literature survey, studies have found that racial differences in mortality rates and disability incidence rates can be largely explained by differences in socioeconomic factors, the most important of which is income.

    * The effect of income on mortality seems to be greatest at lower income levels and appears to decline as income rises, with little effect above average levels of income. The longer an individual is poor, the greater the likelihood that the individual will die before reaching average life expectancy.

    * Similarly, lower income individuals have much higher rates of disability than do higher income individuals.

    * Further, it would appear that, in advanced old age, income plays a progressively smaller role in preventing disease and untimely death.

- Education may also be a factor in disability incidence.

- Education achievement varies by race, ethnicity:

Percent of Workers 18 and over with Selected Levels of Education, By Race, Ethnicity, 1995

	Not a HS Grad	HS Grad	Some College	Bachelor's Degree	Advanced Degree
White (100)	11.9	32.3	29.3	17.5	8.6
Black (100)	16.1	36.7	31.8	11.3	4.0
H.O * (100)	26.2	19.7	15.6	4.7	1.8

source: tablea-03.txt at www.census.gov

- Hispanic Origin (H.O.) may be any race

  * Workers with lower levels of education are often in jobs that are physically demanding, which can lead to a higher incidence of disability. The chart above indicates that blacks and persons of Hispanic Origin are significantly less likely to have earned a Bachelor's Degree than whites.

  * In addition, individuals with less education may be more likely to be awarded disability benefits because the disability severely limits job opportunity.

- When young survivor benefit awards are considered, it appears that blacks are over-represented relative to percent of total population:

Benefit Awards to Children of Deceased Workers & Widowed Mothers and Fathers, 1995

White	Black	Other
62.4%	23.4%	13.5%

- Studies of the OASI program suggest that nonwhites have received higher rates of return than whites, on average, due in part to the historically lower earnings of nonwhites coupled with the progressive benefit formula; these factors appear to outweigh the generally lower life expectancies of nonwhites.

- There have been fewer studies conducted on the effect of race on outcomes under the DI program, but a study underway in ORES suggests that nonwhites have fared relatively better under the program up to the present time, with factors such as lower earnings, higher disability rates, and more auxiliary beneficiaries per disabled worker for nonwhites collectively outweighing the opposing effect of mortality differences.

Attachment:
Literature Survey: *Race, Life Expectancy and Social Security*, ORES, November 1997

Division of Economic Research
Office of Research, Evaluation and Statistics
November 21, 1997

Race and money's worth under Social Security

Differences in mortality rates, disability rates, and earnings levels are important factors that affect the relative treatment of racial minorities under the Social Security OASI and DI programs. Historically, nonwhites have generally experienced higher mortality rates than whites, particularly at ages under about 65-70. Nonwhites have also generally experienced higher disability rates and lower average earnings than whites.

Other things equal, higher mortality rates and the resulting shorter life expectancies can be expected to reduce retirement and disability benefits, but probably increase survivors benefits. Retirement benefits tend to be reduced because shorter life expectancies mean that fewer workers make it to retirement and because those that do attain retirement age have shorter retirement spans. Disability benefits tend to be reduced because disability incidence rates generally increase over the working life, with the most rapid increases occurring near the end of the working life. As such, shorter life expectancies mean that fewer workers live long enough to become disabled and earlier deaths shorten the disability spans of those who do become disabled. Groups with higher disability rates, of course, tend to receive more favorable treatment under the DI program, holding other things equal. Finally, groups with lower earnings tend to be treated more favorably under Social Security, holding other things equal, because of the "tilt" in the benefit formula that provides higher replacement rates for workers with lower lifetime earnings.

Because they work in opposite directions, the net effect of these factors on the relative treatment of racial minorities under Social Security is unclear from a theoretical perspective. It is important to recognize, however, that the differences in mortality and disability rates experienced by minority racial groups appear to be largely attributable to differences in other socioeconomic factors, such as income. Studies that have examined mortality differentials by race (*e.g.*, Rogers [1992]; Menchik [1993]; and Behrman *et al.* [1991]), for example, have found that these differentials can be largely explained by socioeconomic factors; as such, the issue of racial mortality differentials is more appropriately identified as an issue of socioeconomic mortality differentials. Studies of socioeconomic mortality differentials have found that mortality is most consistently and strongly associated with income, rather than other factors such as education and occupation (Duleep [1986], [1995]; Menchik [1993]). Disability also appears to be strongly related to socioeconomic factors, with low income persons having much higher rates of disability than high income persons (Duleep [1986]; Burtless [1987]). As with mortality, then, racial differences in disability likely reflect differences in socioeconomic factors.

Thus, when other socioeconomic factors are controlled for, any remaining racial mortality and disability differentials probably do not have a large effect on the relative treatment of racial minorities under Social Security. When these other socioeconomic factors are not held constant, however, differences in treatment by race under the Social Security program do emerge. Studies of the OASI program, for example, suggest that nonwhites have received higher rates of return than whites, on average (Duggan *et al.* [1993]); the historically lower earnings of nonwhites coupled with the "tilt" in benefit formula appear to outweigh the generally lower survival probabilities for nonwhites when factors other than race are not held constant. There have been fewer studies conducted of the effect of race on outcomes under the DI program, but a study currently underway in ORES suggests that nonwhites have fared relatively better than whites under the program to date, with such factors as the lower earnings, higher disability rates, and higher auxiliary beneficiaries to disabled worker beneficiary ratios experienced historically by nonwhites collectively outweighing the likely opposing effect of simple mortality differentials.

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SOCIAL SECURITY'S RATE OF RETURN BY WILLIAM W. BEACH AND GARETH E. DAVIS

No. 98–01 January 15, 1998

What can Americans expect in future Social Security retirement benefits? A Heritage Foundation study reveals that the Social Security system's rate of return for most Americans will be vastly inferior to what they could expect from placing their payroll taxes in even the most conservative private investments. For the low-income African-American male age 38 or younger, the news is particularly grim: He is likely to pay more into the Social Security system than he can ever expect to receive in benefits after inflation and taxes. Staying in the current system will likely cost him up to $160,000 in lifetime income in 1997 dollars.

If Americans were allowed to direct their payroll taxes into safe investment accounts similar to 401(k) plans, or even super-safe U.S. Treasury bills, they would accumulate far more money in savings for their retirement years than they are ever likely to receive from Social Security. For example:

• Social Security pays a very low rate of return for two-income households with children.—Social Security's inflation-adjusted rate of return is only 1.23 percent for an average household of two 30-year-old earners with children in which each parent made just under $26,000 in 1996.[1] Such couples will pay a total of about $320,000 in Social Security taxes over their lifetime (including employer payments) and can expect to receive benefits of about $450,000 (in 1997 dollars, before applicable taxes) after retiring at age 67, the retirement age when they are eligible for full Social Security Old-Age benefits.[2] Had they placed that same amount of lifetime employee and employer tax contributions into conservative tax-deferred IRA-type investments-such as a mutual fund composed of 50 percent U.S. government Treasury bills and 50 percent equities-they could expect a real rate of return of over 5 percent per year prior to the payment of taxes after retirement. In this latter case, the total amount

[1] This rate of return calculation assumes that both adults were born in 1967.

[2] Total taxes paid and benefits received are expressed in 1997 inflation-adjusted dollars. Social Security taxes are defined as Old-Age and Survivors Insurance (OASI) contributions, less (where applicable) an amount which would buy a life insurance policy equivalent to the value of the coverage provided by (pre-retirement) Survivors Insurance. In 1997, the tax rate for OASI is 10.7 percent of all wages and self-employment income less than $65,400, as of year-end 1997. Unless stated otherwise, a discount rate is not applied to these amounts.

of income accumulated by retirement would equal approximately $975,000 (in 1997 dollars, before applicable taxes).

• The rate of return for some ethnic minorities is negative.—Low-income, single African-American males born after 1959 face a negative real rate of return from Social Security. For every dollar he has paid into Social Security, a low-income, single African-American male in his mid-20s who earned about 50 percent of the average wage, or $12,862, in 1996 can expect to get back less than 88 cents. This negative rate of return translates into lifetime cash losses of $13,377 (in 1997 dollars) on the taxes paid by the employer and employee.

African-American females typically live longer than their male counterparts, yet even they have a rate of return lower than the general population. An African-American single mother 21 years old who in 1996 made just under $19,000 (the average for African-American females) can look forward to a real rate of return on her Social Security taxes of only 1.2 percent. Under conservative assumptions, if she had saved those same tax dollars in a private investment account composed of government bonds, she would have received a real return of around 3 percent per year. With a mixed portfolio of bonds and equities, she could expect a return on her investments of at least 4.35 percent. This means that even with a low risk/low yield portfolio composed entirely of Treasury bills, this single mother could have generated at least $93,000 more in retirement income (in after-tax 1997 dollars) than she would enjoy under Social Security.[3]

• The rate of return has a damaging impact on communities.—The cumulative effects of Social Security's dismal rates of return can be appreciated by considering a hypothetical community. Suppose there existed a city entirely of 50,000 young, married double-earner couples in their thirties, with each person earning the average wage, and each couple had two children. The cumulative amount such a community could save in a private pension plan by retirement with the same dollars they currently pay in Social Security taxes is over $26 billion greater than these couples will get in Social Security benefits. This amount is roughly equal to the amount the federal government currently spends on food stamps each year for the whole nation, and nearly as much as direct federal spending on education.[4]

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[3] Assuming that upon retirement this single woman is able to annuitize the lump sum at retirement that she accumulated at a real interest rate of 2.7 percent over 15 years. The current federal income tax rates (with current rate structure, exemptions, tax bands, and deductions adjusted by inflation as mandated in current legislation) are applied against this annuity income.

[4] Scott A. Hodge, ed., Balancing America's Budget: Ending the Era of Big Government (Washington, D.C.: The Heritage Foundation, 1997).

Key Assumptions and Methodology
(For details, see Appendix)

- "Rate of Return" is a statistic commonly used to measure the income performance of an investment. It represents the annual rate of increase in the value of an investment and is usually expressed in percentage terms.
- All calculations are adjusted for inflation.
- Both the employee's and employer's share of payroll taxes are included in the calculations.
- Unless otherwise noted, after-tax Social Security benefits and private investment returns are used for comparisons. That is, applicable income taxes have been subtracted from Social Security retirement benefits (in the few cases where those benefits are taxable) and from the retirement incomes derived from private retirement savings.
- The estimated insurance cost of pre-retirement survivors benefits is subtracted from Old-Age and Survivors Insurance (OASI) payroll taxes. Thus, only retirement income taxes and benefits are compared.
- Future increases in life expectancy and wages are taken into account and, unless otherwise stated, are consistent with the intermediate assumptions of the Board of Trustees of the OASI trust fund.
- Unless otherwise indicated, the "private" investment alternatives described in this study are based on tax-deferred IRA-type accounts, but with initial contributions not tax-deductible.

WHY RATES OF RETURN MATTER

The defenders of Social Security argue that rates of return are irrelevant to the Old-Age and Survivors Insurance (OASI) portions of the program. Social Security, they suggest, was intended to provide a basic but decent retirement income to beneficiaries and stop-gap incomes for surviving spouses. Future Social Security beneficiaries, they argue, should be saving now for additional retirement income to supplement benefits from the Old-Age and Survivors Insurance. Thus, they argue that comparing rates of return on private pension investments with those from a public program intended to pay out during retirement at least 35 percent of the wages an average worker earned prior to retirement is like comparing apples with oranges.[5]

This line of reasoning contains a fundamental flaw. If Social Security taxes were low enough to allow workers to save these additional dollars for their retirement, apologists for the system might conceivably be correct in characterizing Social Security as a pension program of last resort. But Social Security taxes are not low, and they are crowding out the ability of most low-and middle-income Americans to save for retirement. Thus, the rate of return on these taxes is very important, especially for those Americans for whom Social Security is their main retirement savings.

Crowding Out Savings. As payroll taxes have risen, many more Americans have few dollars left over for supplemental retirement investment. Over the past 25 years, Congress and the President have increased Old-Age and Survivors benefits so often and so much that today the high payroll taxes needed to pay those current benefits crowd out private retirement investments.[6] In 1972, the average worker (with his or her employer) paid 8.1 percent in Old-Age and Survivors payroll taxes on the first $9,000 of wages and salary (equivalent to about $21,500 in 1997 dollars);[7] in 1997, that worker paid 10.7 percent on the first $65,400 of "earned" income (or the first $27,340 in 1972 dollars).[8] Moreover, between 2020 and 2046, the Old-Age and Survivors tax rate will have to rise to 14.4 percent from today's 10.7 percent if benefit costs are not cut.[9]

Because of rising payroll taxes for retirement, increasing numbers of poor and middle-income workers do not have the after-tax funds needed to create private supplemental pension investments.[10] In fact, Social Security taxes now consume as much of the average family's budget as do outlays for housing, and nearly three times more than annual health care expenses.[11]

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[5] See Social Security Administration, "Findings and Recommendations," 1997 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, Communication from the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, House Doc. 104–228 (Washington, D.C.: U.S. Government Printing Office, 1997), Table R1, p. 36.

[6] See Martin Feldstein, "The Missing Piece in Policy Analysis: Social Security Reform," A.E.A. Papers and Proceedings, May 1996, pp. 1–14.

[7] Social Security Administration, 1997 Annual Report of the Board of Trustees, Table II.B1, pp. 34–35. The percentage of wages and salaries taxed to support the Old-Age and Survivors and Disability Insurance programs (Social Security taxes) equals the 50 percent paid directly by the employee plus the 50 percent paid by the employer on the employee's behalf. The employer's half comes from wages the family would have earned had there not been a payroll tax.

[8] Taxable threshold levels for 1972 and 1997 adjusted by the index value for the Consumer Price Index—All Urban Series. See Economic Report of the President (Washington, D.C.: U.S. Government Printing Office, 1997), Table B-58, p. 365.

[9] Heritage Foundation estimates based on data from the Social Security Administration's 1997 Annual Report of the Board of Trustees, Table II.F14, p. 112.

[10] This is complicated by the decreasing number of firms that provide company pensions to their workers. Rising taxes of all kinds, costly regulations, and increasing pressures on the bottom line have led many firms away from the practice of providing pensions for long-time employees.

[11] Data on average family consumption expenditures from U.S. Department of Labor, Bureau of Labor Statistics, "Consumer Expenditures in 1995," June 1997, Table A. This report estimates average family income before taxes to be $36,918. Heritage analysts added $2,289 to reflect additional wages the average worker would receive if the employer's share of Social Security was converted to wages.

Because of the long-term financial problems of the Social Security trust fund, calculations of the rate of return for Social Security are likely to prove optimistic. The fact is that Social Security will not be able to pay out old-age benefits to the "Baby Boom" generation without additional tax increases on workers or benefit cuts. These tax increases or benefit cuts will further reduce the Social Security rates of return for those workers currently in their twenties, members of the so-called Generation X, and their children. As Social Security's rates of return fall, the relevance of rates of return on private pensions rises. That is, members of Generation X are not simply going to ignore the decaying prospects for adequate income during their retirement years. Rather, they will insist increasingly on more opportunities for creating pensions to supplement Social Security's Old-Age benefits. Thus, comparing rates of return for private and public pensions will become even more important to each new generation.

In addition, the rate of return is important because the crowding-out effects of high Social Security taxes on private savings for low-and middle-income workers affect the wealth that can be left to the next generation. Few aspects of Social Security are as unintended or as damaging to low-and middle-income workers as the squeeze that high payroll taxes put on the formation of intergenerational wealth transfers. The inability of poor workers to accumulate enough savings to leave a nest egg to their children can mean that their children will be as dependent as their parents could be on their monthly Social Security check. It means that poor communities will not have as much "home grown" capital with which to create new jobs and sources of income. Without these new jobs and income, members of the next generation will be less able to save for retirement than they could be. Thus, by taxing away one generation's opportunity to help the next generation start earning at a higher level, the Social Security system acts as a drag on future generations.

Cumulative Effect on Communities. Although a low rate of return on rising Social Security taxes reduces the potential retirement savings of individual households, it is important to appreciate the cumulative effect this has on communities. In both rich and poor communities, less money accumulated in each household for retirement years means less money in the community not just for living expenses, but also for new businesses, for sending children to college, and generally for giving the next generation a more secure financial foundation. In short, each succeeding generation in a community is weakened financially by a poor rate of return from Social Security.

For a very rough picture of the cumulative impact on a community, consider a hypothetical small community of 200,000 residents. In this imaginary community, there are 50,000 families of four; all the parents are age 30; and both parents work, earning the average wage of $26,000 (in 1997 dollars). Assume that nobody migrates into or out of this neighborhood. In this greatly simplified hypothetical community, the difference between the lifetime amount of savings the parents would accumulate by placing their Social Security tax dollars in conservative portfolios and the amount actually obtained from Social Security would be approximately $26 billion in 1997 dollars (based on family cases analyzed later in this study). This is the savings they must forego due to the failing Social Security tax system and, in effect, is money drained from their community during their working years.

To be sure, this example is completely fictitious, and actual calculations for real communities would vary widely. But this example serves to illustrate that the deficiencies of Social Security for individual households imply a significant impact on the long-run financial health of American communities.

How a Small Difference in Returns Means Big Differences in Cash

The power of compound interest over a career can translate even small differences in the rate of return into large swings in lifetime savings. For example, the expected annualized real rate of return for Social Security is 1.2 percent for an average-income, 21-year-old African-American single mother of two who throughout her lifetime makes about 100 percent of the average earnings for African-American female workers ($18,650 in 1996).[1]

Had she been allowed to invest her payroll taxes in highly conservative investments, she could expect to make a 3 percent real rate of return on a portfolio consisting entirely of Treasury bills, or a 4.35 percent real rate on a portfolio of 50 percent Treasury bills and 50 percent equities.

Investing her taxes entirely in Treasury bills would give her an annualized rate of return that is almost two percentage points higher than she could expect from Social Security, and allow her to earn—during her lifetime—$93,330 more in terms of inflation-adjusted, after-tax 1997 retirement income than she can expect to receive in Social Security benefits.

Investing in the mixed equity/bond portfolio would yield a rate of return 3.14 percentage points greater than she could receive from Social Security and would allow her to accumulate by retirement a lump sum that, in after-tax 1997 dollars, is $192,073 more than her lifetime projected value of Social Security benefits.

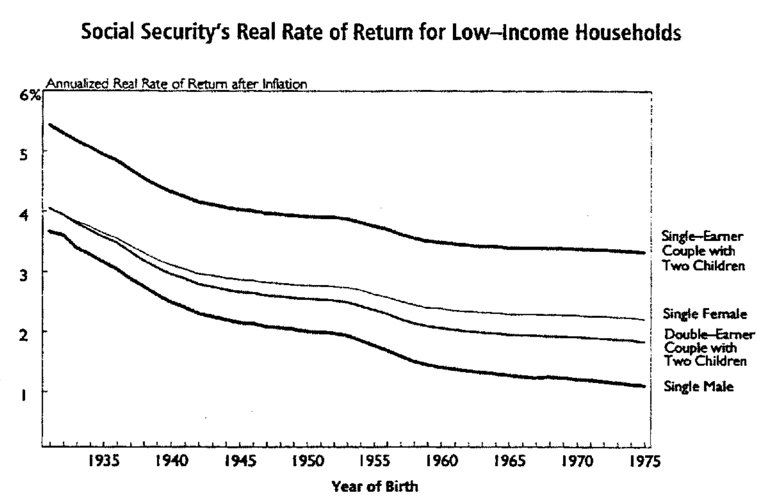
1. The Social Security Administration's "Average Wage Index" as defined in the *1997 Annual Report of the Federal Old-Age and Survivors and Disability Trust Funds*, Table III.B1, p. 178. A ratio of 72.5 percent of average earnings is assumed for the African-American single mother, which was the proportion of average earnings made by African-American females at the end of 1996 as reported in U.S. Department of Labor, "Usual Weekly Earnings of Wage and Salary Workers, Fourth Quarter, 1996," January 24, 1997, Table 1.

SOCIAL SECURITY'S RATES OF RETURN FOR HOUSEHOLDS

The authors calculated Social Security's inflation-adjusted (or "real") rates of return for various segments of the population and compared these returns with the rates of return workers could receive if they were allowed to invest their Social Security taxes in safe, private retirement investments.[12] These calculations show that families at all income levels receive dismal returns for the lifetime taxes they pay.

Defenders of Social Security often argue that Old-Age and Survivors benefits help low-income workers especially. But do they? Does Social Security give low-income Americans a decent return on all of the taxes they pay into the system over their lifetime of work? [13]

As Chart 1 indicates, a low-income family will likely receive at best a mediocre and at worst a very poor real rate of return from Social Security, despite the fact that Social Security's formulae are designed expressly to redistribute income toward workers with low income. Single-earner low-income couples born before 1935, who have paid much lower lifetime payroll taxes, are better than do much younger workers. However, even the best-case rate of return (5.37 percent for a single-earner couple with children in which the worker was born in 1932) lies below 7 percent, a conservative estimate of what economists estimate to be the long-range real rate of



Notes: Earners are assumed to make 50 percent of the average earnings as defined by the Social Security Administration ($12,862 in wage, salary, and self-employment income in 1996). Rate of return is based on Old–Age and Survivors portion of taxes and benefits only and is net of taxes.

Sources: Heritage calculations and *1997 Trustees Report*, Social Security Administration; and National Center for Health Statistics. *Vital Statistics of the United States*, 1992 Life Tables, 1997.

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[12] Heritage analysts reduced all rates of return and related calculations presented in this paper by the annual inflation rates for the years between 1997 and 2040, as forecast by the Board of Trustees of the Social Security Old-Age and Survivors Insurance Trust Fund in their 1997 annual report. This adjustment to rates of return, Social Security benefits, and privately managed savings means that the reader is always shown sums and earnings ratios in terms of a dollar's purchasing power today. Thus, the statement "Social Security will pay out an annual amount of $17,000 in the year 2040" means that the program will pay enough to allow a beneficiary to purchase then what $17,000 will purchase now. In order for a beneficiary to have that much "purchasing power" in the year 2040, as he has today, Social Security will actually have to send this person around $100,000 annually. The difference between the two amounts is explained by the effects of inflation on the dollar's value, or by what a dollar will buy in 2040 after years of decreasing value due to inflation.

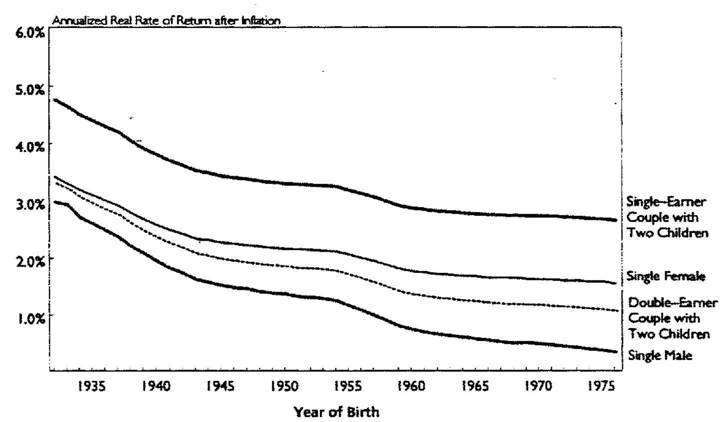
[13] Generally speaking, a low-income earner is defined in Social Security Administration simulations as someone who earns 50 percent of the average wage. In 1996, a person defined as low-income earned approximately $12,862 per annum.

return on equities.[14] Every other low-income group lies below this rate of return, or well below the rates of return available to Americans who have opportunities to invest in stocks and bonds for the long term. Double-earner low-income families, as well as single low-income males and females, fare badly under Social Security. Low-income single males are hit particularly hard because of the lower male life expectancy and absence of spousal and survivor's benefits. The expected real rate of return from Social Security for low-income males falls from a high of 3.6 percent for those born in 1932 to 1.0 percent for those born in 1976-well below what could be realized from a prudent private investment portfolio.

Chart 2 shows rates of return for average-income families.[15] All of the groups fare badly under Social Security relative to the return that they could receive from a conservative private investment portfolio. A married couple with two children and a single earner fare best, receiving 4.74 percent if the earner was born in 1932. This expected rate of return falls gradually to less than 2.6 percent for those born in 1976. As in the low-income scenario, single males fare worst of all. An average-earning single male born after 1966 can expect to receive an annualized real rate of return of less than 0.5 percent (less than one-half of 1 percent) on lifetime payroll taxes.

Chart 2 CDA98-01

Social Security's Real Rate of Return for Average–Income Households



Note: Earners are assumed to make 100 percent of the average earnings as defined by the Social Security Administration ($25,723 in wage, salary, and self-employment income in 1996). Rate of return is based on Old–Age and Survivors portion of taxes and benefits only and is net of taxes.
Sources: Heritage calculations and 1997 *Trustees Report*, Social Security Administration; and National Center for Health Statistics, *Vital Statistics of the United States*, 1992 Life Tables, 1997.

[14] Report of the 1994–1996 Advisory Council on Social Security, Vol. I: Findings and Recommendations, p. 35.

[15] An average-income family is defined by the Social Security Administration as one in which the earners receive the average wage earned by all of those covered by Social Security. In 1996, earners in such families are estimated to have received $25,723.

Table 1 shows selected Social Security rates of return for the general population, for African-Americans, and for Hispanic-Americans.

Table 1 CDA98-01

Social Security Rates of Return for African–Americans, Hispanic–Americans, and the General Population, by Date of Birth

General Population

	Low Income				Average Income				High Income			
Year of Birth	Single Male	Single Female	Single-Earner Family with Two Children	Double-Earner Family with Two Children	Single Male	Single Female	Single-Earner Family with Two Children	Double-Earner Family with Two Children	Single Male	Single Female	Single-Earner Family with Two Children	Double-Earner Family with Two Children
1950	1.97%	2.71%	3.86%	2.49%	1.34%	2.14%	3.28%	1.88%	0.01%	0.97%	2.12%	0.63%
1960	1.38%	2.33%	3.44%	2.02%	0.72%	1.75%	2.85%	1.39%	-0.90%	0.34%	1.42%	-0.12%
1970	1.15%	2.20%	3.31%	1.85%	0.47%	1.60%	2.71%	1.20%	-1.27%	0.14%	1.21%	-0.39%

African–American

	Low Income				Average Income				High Income			
Year of Birth	Single Male	Single Female	Single-Earner Family with Two Children	Double-Earner Family with Two Children	Single Male	Single Female	Single-Earner Family with Two Children	Double-Earner Family with Two Children	Single Male	Single Female	Single-Earner Family with Two Children	Double-Earner Family with Two Children
1950	0.99%	2.45%	3.47%	2.04%	0.29%	1.67%	2.70%	1.20%	-1.29%	0.41%	1.51%	-0.20%
1960	-0.18%	1.94%	2.87%	1.31%	-0.96%	1.14%	2.09%	0.43%	-2.94%	-0.38%	0.60%	-1.27%
1970	-0.66%	1.80%	2.71%	1.07%	-1.50%	0.98%	1.90%	0.15%	-3.66%	-0.61%	0.35%	-1.64%

Hispanic–American

	Low Income				Average Income				High Income			
Year of Birth	Single Male	Single Female	Single-Earner Family with Two Children	Double-Earner Family with Two Children	Single Male	Single Female	Single-Earner Family with Two Children	Double-Earner Family with Two Children	Single Male	Single Female	Single-Earner Family with Two Children	Double-Earner Family with Two Children
1950	2.51%	3.10%	4.16%	2.95%	1.75%	2.39%	3.46%	2.20%	0.50%	1.28%	2.41%	1.01%
1960	2.00%	2.74%	3.78%	2.52%	1.20%	2.02%	3.06%	1.75%	-0.31%	0.67%	1.74%	0.31%
1970	1.78%	2.63%	3.66%	2.36%	0.96%	1.89%	2.93%	1.57%	-0.64%	0.49%	1.55%	0.06%

Note: The rates of return displayed in this table are preliminary estimates. They have been constructed using the methodology outline in the Technical Appendix. In accordance with current statistical practices employed by the Social Security Administration's Office of the Actuary and by major research organizations, these rates of return have not been adjusted for life expectancy variations associated with income. If these complex adjustments were to be made, the rates of return for low–income workers would tend to decrease and those for high–income workers would tend to be higher.
Source: Heritage calculations, based on *1997 Trustees Report*, Social Security Administration and National Center for Health Statistics, *Vital Statistics of the United States*, 1992 Life Tables, 1997.

What Do These Rates of Return Mean in Dollar Terms?

Due to the power of compound interest, even what appears to be a relatively small difference in the real rate of return can have significant implications for a family's lifetime accumulated wealth. In order to analyze the dollar implications of Social Security's lower rate of return, the authors calculated the inflation-adjusted differences between Social Security's benefits and what a fairly conservative investor could accumulate by retirement from a portfolio split equally between long-term U.S. Treasury bills and broad market equity funds.

A low-income single-earner couple with children whose wage earner is 41 years old in 1997 can expect to receive about $202,000 in Social Security benefits in return for a lifetime of payroll taxes. Those 31 and 21 years old in 1997 can expect to receive around $215,400 and $240,200, respectively, in benefits. However, by investing these same tax dollars in a portfolio made up of 50 percent U.S. Treasury bills and 50 percent blue-chip equities, these three wage earners could accumulate by retirement an estimated $230,200, $241,000, and $249,000 in 1997 dollars, respectively.[16]

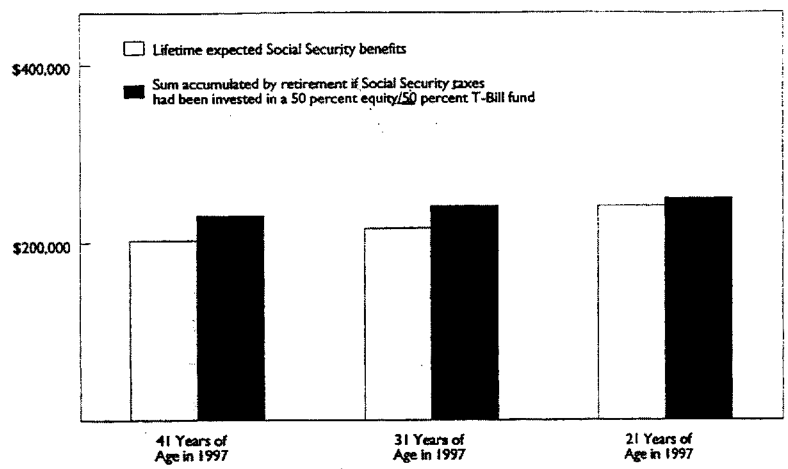
Hence, staying in the Social Security program means that low-income married couples will bear a cost of about $28,200, $25,600, and $8,800 for wage earners who were born in 1956, 1966, and 1976, even though this group has the highest rate of return from Social Security. Indeed, these amounts are likely to underestimate the gain from a private retirement plan, since they do not include any of the interest a couple can expect to earn on the accumulated sum in the period after retirement.

Social Security poses even greater costs for groups with lower rates of return than low-income single-earner couples. A single male earning what the Social Security Trustees call "an average income" (or $25,723 in 1996) is particularly hard-hit by Social Security's low returns. A 21-year-old single male making an average income throughout his lifetime can expect to lose $309,400 in potential retirement income by staying in Social Security when compared with what he would earn if he invested his payroll taxes in a safe, conservative private retirement fund made up of 50 percent equities and 50 percent government bonds. A 31-year-old single male who earns what the Social Security Trustees call an average income will lose $311,000 over the income a conservative private portfolio would likely yield, while a similar 41-year-old will forego $296,000 (in 1997 dollars).

[16] These amounts reflect the buildup of retirement savings in tax-deferred IRA-type investment portfolios and are prior to the payment of any applicable income taxes.

Chart 3 CDA98-01

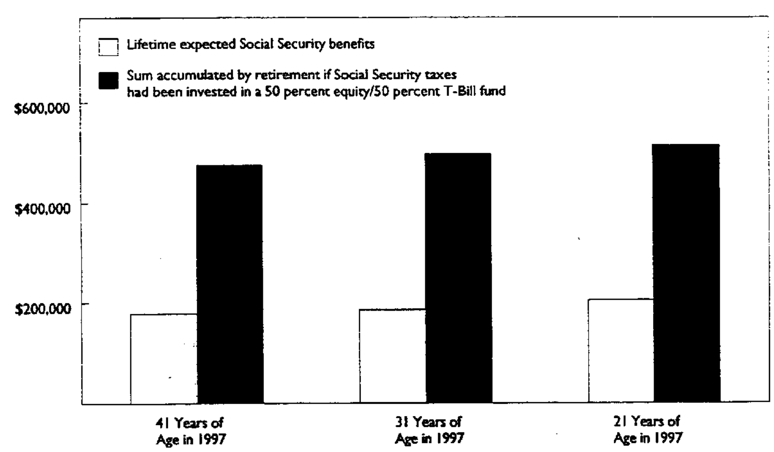
How Single-Earner, Low–Income Families with Two Children Fare on Social Security Compared with Private Investments (1997 Dollars)



Notes: These accounts may be subject to post–retirement income taxes. The earner in this family is assumed to make 100 percent of the average earnings as defined by the Social Security Administration ($12,682 in wage, salary, and self-employment income in 1996). Assumes the individual places contributions in a tax–deferred IRA–type account (but with initial contributions not tax–deductible).
Sources: *1997 Trustees Report*, Social Security Administration; and National Center for Health Statistics, *Vital Statistics of the United States*, 1992 Life Tables, 1997.

Chart 4 CDA98-01

How an Average–Income Male Fares in Social Security Compared with Private Investments (1997 Dollars)

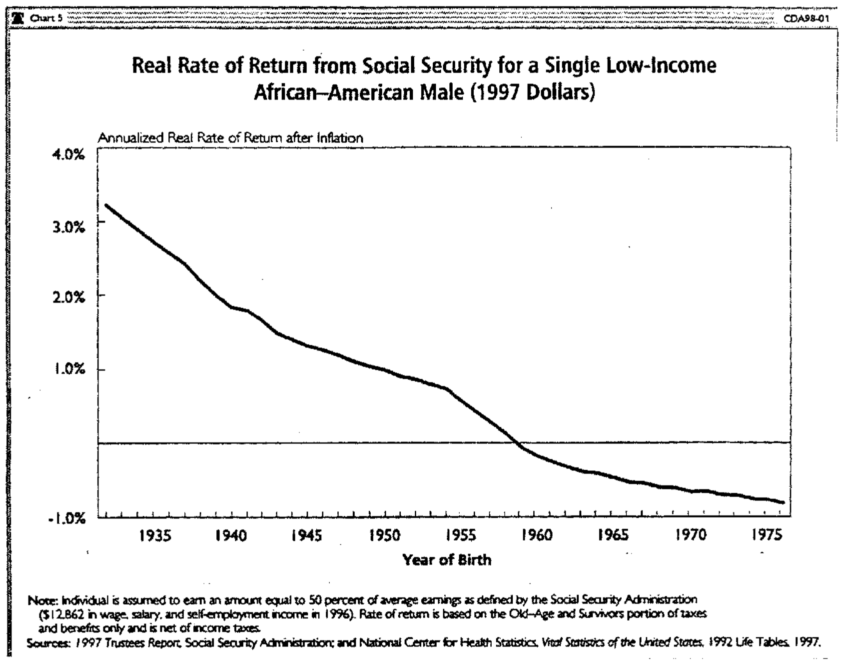


Note: These accounts may be subject to post–retirement income taxes. The earner is assumed to make 100 percent of the average earnings as defined by the Social Security Administration ($25,723 in wage, salary, and self-employment income in 1996). Assumes the individual places contributions in a tax–deferred IRA–type account (but with initial contributions not tax–deductible).
Sources: *1997 Trustees Report*, Social Security Administration; and National Center for Health Statistics, *Vital Statistics of the United States*, 1992 Life Tables, 1997.

SOCIAL SECURITY AND AFRICAN-AMERICANS

Due to generally lower life expectancies, African-Americans experience particularly poor rates of return from Social Security. This means, among other things, that Social Security taxes impede the intergenerational accumulation of capital among African-Americans, a group which has found it difficult to acquire capital. In fact, even under the most optimistic assumptions, Social Security taxes actually shrink the lifetime net earnings of some of the least advantaged members of the community.

Despite efforts to transfer resources toward low-income individuals through Social Security, low-income African-American males realize particularly dismal rates of return from Social Security, even under the most favorable assumptions. Chart 5 shows the real rate of return from Social Security for African-American males who earn what the Social Security Trustees call "low-income" annual earnings throughout their life-about $12,862 in 1996. Chart 5 also illustrates how the best intentions of Social Security's defenders to help low-income minorities are frustrated by the program's dismal rates of return.[17]



An African-American, low-income single male born in 1932 and retiring today can expect a rate of return of approximately 3.23 percent on his lifetime contributions. However, this rate of return falls for younger African-American males. Indeed, the expected rate of return from Social Security for those born after 1959 is negative. This means that a typical, low-income African-American male 38 years old or younger can expect to pay more into the Social Security system than he will likely receive after inflation and federal income taxes. Put another way, this person's lifetime purchasing power, or the ability to buy the same goods and services in retirement that he buys today, actually shrinks as a result of his participation in the Social Security program.

To gauge how much of his purchasing power this future retiree may forego by staying in Social Security, the authors calculated the amount of money that a 25-year-old, low-income African-American male could accumulate by retirement if he

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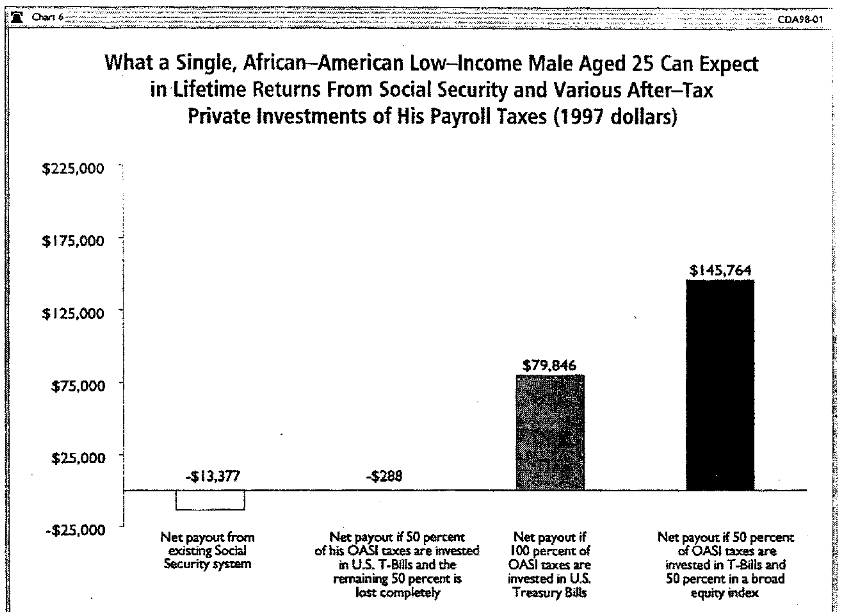
[17] Indeed, life expectancy for this African-American male is likely to be lower than the one used. Life expectancy is closely related to earnings, and while the average African-American male worker in the last quarter of 1996 had earnings of 82.8 percent of the national average, the above worker has only earnings of 50 percent of the average. See footnote 11, supra.

invested his payroll taxes privately. This inflation-adjusted sum was compared with the amount he can expect to receive from Social Security, all in 1997 dollars.

Three scenarios for alternative rates of return are presented in Chart 6. They examine the after-federal-income tax benefits, assuming the contributions were placed in a tax-deferred IRA-type account.[18] The first scenario assumes that the worker invests 50 percent of his taxes in U.S. Treasury bills and 50 percent in a broad equity index. The second scenario assumes that all payroll taxes are invested entirely in T-bills. The third scenario assumes the worst case: that the worker invests 50 percent in U.S. Treasury bills and loses all of the remaining half in bad investments.

As Chart 6 shows, the current Social Security system can be expected to shrink this individual's net lifetime income by $13,377 in terms of 1997 dollars. He is likely to fare better, even if he were to lose half of his invested tax dollars completely, by an amount of $13,089, compared with Social Security's rate of return.



Note: Individual is assumed to earn an amount equal to 50 percent of the average earnings as defined by the Social Security Administration ($12,862 in wage, salary, and self-employment income in 1996). Rate of return is based on OASI taxes, benefits, and is net of income taxes. The worker is assumed to annuitize his retirement savings over 15 years, receiving a real rate of return of 2.7%. Assumes the individual places contributions in a tax-deferred IRA–type account (but with initial contributions not tax-deductible).

Sources: *1997 Trustees Report*, Social Security Administration; and National Center for Health Statistics, *Vital Statistics of the United States*, 1992 Life Tables, 1997.

Moving beyond the extreme worst-case outcome, the results are even more striking. Under conservative assumptions, a 100 percent T-bill portfolio will result in an increase in a lifetime income net of taxes of $79,846, while a 50 percent bond/50 percent equity portfolio will likely result in a net increase in post-tax lifetime income of $145,764.

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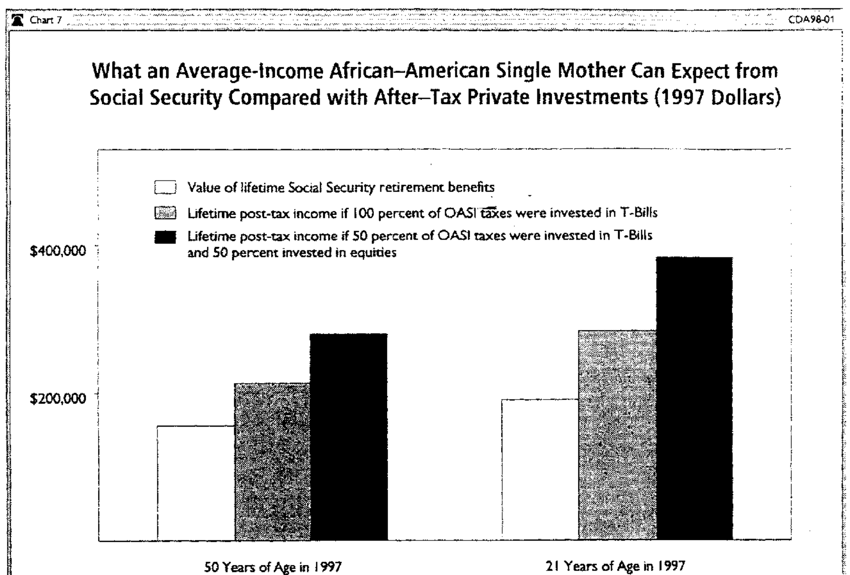
[18] The amounts below assume that the worker pays out the amount he has accumulated in an annuity over his lifetime and receives an interest rate of 27 percent. The current federal income tax rates (with current rate structure, exemptions, tax bands, and deductions adjusted by inflation as mandated in current legislation) are applied against this annuity income.

The nature of the current Social Security system also imposes a heavy burden on single-parent families. Chart 7 illustrates some of the total lifetime costs experienced by two typical African-American single mothers of different ages but each earning an annual salary of $18,650 in 1996. The expected total Social Security benefits are presented in the chart, as well as the amount that each woman would have accumulated by retirement had she been able to invest her Social Security taxes under two sets of assumptions: (1) an “ultra-conservative” portfolio in which all of her taxes were invested in U.S. Treasury bills, and (2) a portfolio in which 50 percent was invested in Treasury bills and 50 percent in a broad equity fund.



Note: Individual is assumed to earn an amount equal to 72.5 percent of the average earnings as defined by the Social Security Adminstration ($18,650 in wage, salary, and self-employment income in 1996). All values reflect the payments of appropriate taxes. The single mother is assumed to annuitize her retirement savings over 15 years, receiving a real rate of return of 2.7%. Assumes the individual places contributions in a tax–deferred IRA–type account (but with initial contributions not tax–deductible).

Sources: *1997 Trustees Report*, Social Security Administration; and National Center for Health Statistics, *Vital Statistics of the United States*. 1992 Life Tables. 1997.

In return for a lifetime of contributions to Old-Age and Survivors Insurance, the 50-year-old single mother can expect to receive, on average, $155,903 in Social Security benefits while a 21-year-old can expect to receive $190,767. In each case, private strategies yield much higher returns than Social Security. An ultra-conservative investment program in which all of their savings are invested in long-term government bonds would yield post-tax lifetime amounts of $213,220 and $284,098 for the 50-year-old and 21-year-old, respectively-a net gain over Social Security of $57,317 and $93,330.[19]

The gains from a prudently mixed portfolio of bonds and equities are even greater. Had their taxes been invested in a mixed portfolio of 50 percent bonds and 50 percent equities, the 50-year-old would receive at least $280,016 in lifetime post-tax income and the 21-year-old would receive $382,840 (in 1997 dollars). This represents, respectively, $124,113 and $192,073 more than they could expect to receive from Social Security.

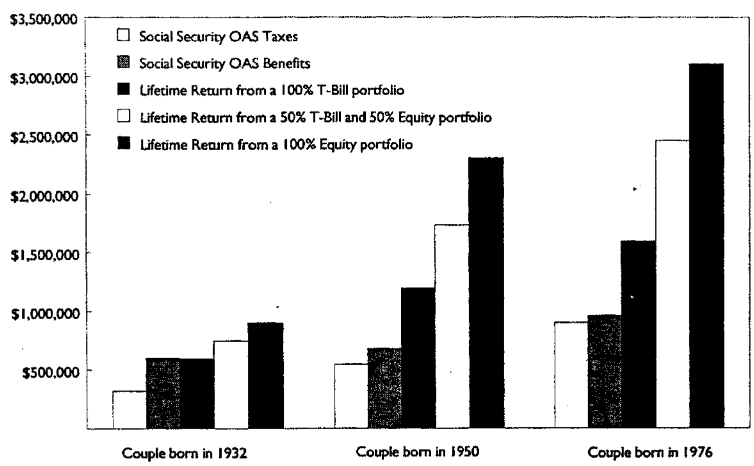
[19] The current federal income tax rates (with current rate structure, exemptions, tax bands, and deductions adjusted by inflation as mandated in current legislation) are applied against this annuity income.

SOCIAL SECURITY AND UPPER-MIDDLE-INCOME AMERICANS

Even for affluent groups, with their ability to supplement Social Security, the lifetime cost of the current Social Security system is by no means trivial in terms of economic well-being. Chart 8 shows the effects on the lifetime wealth and savings of an upper-middle-income, white married couple in New York who have two children and who, in 1996, each earned $77,166 (for a combined income of $154,332).

Chart 8 CDA98-01

What a White New York Upper–Income Couple Can Expect from Social Security Compared with Lifetime After–Tax Income from Private Investments (1997 dollars)



Note: Each spouse is assumed to earn three times the average wage as defined by the Social Security Administration ($77,169 in 1996). Couple has two children and is assumed to annuitize their retirement savings over 15 years, receiving a real rate of return of 2.7 percent. All values reflect the payments of appropriate taxes. Assumes the individual places contributions in a tax–deferred IRA–type account (but with initial contributions not tax–deductible).
Sources: *1997 Trustees Report,* Social Security Administration; and National Center for Health Statistics, *Vital Statistics of the United States,* 1992 Life Tables, 1997.

For such couples, the lifetime inflation-adjusted Social Security tax burden will increase from $323,500 for those born in 1932 to just over $902,050 for those born in 1976. By contrast, this couple would likely gain enormously from private investment of their tax dollars. For couples born in 1932, 1950, and 1976, investing their tax dollars in a broad market equity fund would generate $900,426, $2,304,370, and $3,104,259, respectively, in after-tax lifetime 1997 dollars.[20] This can be compared with their respective expected total lifetime Social Security benefits of $602,776, 682,372, and $956,959.[21]

The economic costs of the current system become even clearer when lost capital accumulation and income opportunities are assessed. Not only does Social Security reduce the income and the ability of these New York couples to save, but their reduced savings translate into less capital for expanding businesses, fewer jobs for others, and, ultimately, a lower standard of living for the entire community.

Why would economic activity be lower if Social Security taxes come back to the community in the form of Social Security benefits? Most economists agree that savings and investment contribute more to economic growth than personal consumption spending. Newer and better machines make workers more productive than longer vacations and a new pair of exercise shoes. Even new savings invested in government bonds cause interest rates to fall and increase private investment. However, under the current pay-as-you-go system, Social Security taxes are consumed primarily in paying benefits to current retirees who spend nearly all of their income

[20] The current federal income tax rates (with current rate structure, exemptions, tax bands, and deductions adjusted by inflation as mandated in current legislation) are applied against this annuity income.

[21] In line with upper-bound estimates of the effects of higher income on life expectancy, the remaining life expectancy of this couple is increased by 10.2 percent for the male and 8.2 percent for the female. See footnote 28, infra.

on personal consumption items. In a privatized system, these funds would be transformed into investments, adding to the capital stock of the nation and enhancing productivity and economic growth.

If the upper-middle-income couple born in 1950 had been allowed to invest their tax dollars in U.S. Treasury bills, they would have accumulated $1.22 million in 1997 dollars by the date of retirement.[22] A portfolio composed entirely of high-grade stocks would have created $2.58 million in new private capital by retirement. For a high-income couple born in 1972 (25 years old today), the investment of their Social Security taxes in private equities would have created $3.65 million in new capital by the date of retirement. By contrast, other than the relatively small surplus that is invested in the trust funds, the current pay-as-you-go Social Security system creates no new savings or capital.[23]

CONCLUSION

When the Social Security system began, its aim was to help ordinary Americans and those in disadvantaged positions to have adequate financial security in their retirement years. However, as this analysis has shown, the current Social Security system may actually decrease the lifetime well-being of many socioeconomic groups, even under the most favorable assumptions. Among the groups who will lose out under the current system are single mothers, low-income single males, average-income married couples with children, and even affluent professionals. Indeed, many ordinary Americans already understand that the Social Security system is a bad deal. Recent surveys have shown that many workers expect to pay more, in real terms, into the system than they ever expect to receive in retirement benefits.[24]

This analysis of the Social Security system almost certainly underestimates its total economic costs. It makes no attempt, for instance, to include the benefits from faster economic growth, higher wages, and increased employment generated by a retirement program in which individuals are allowed to invest their Social Security tax dollars and build the wealth necessary to sustain them in their old age.

Although the debate on Social Security reform at times may focus on technical terms (such as the "replacement ratio" and the trust fund's "long-range actuarial balance") which mean little or nothing to ordinary American families, there is little doubt that the outcome of the debate will be profoundly important to them. For example, whether or not the current system will continue to exist—perhaps sustained by benefit cuts and tax increases—is a matter of great concern to the 21-year-old African-American single mother described earlier. Under a system where she could invest her own tax dollars, this woman perhaps could accumulate enough to buy an annuity upon retirement that would pay about $28,800 a year after taxes,[25] almost twice what she would receive from Social Security, or an annuity equal to her Social Security retirement benefits and pass on the remainder, around $200,000, to her children.

But this debate is also a concern to the thirty-something married couple who earned a combined income of $52,000 in 1996 and struggle to put away enough for retirement while paying over one-eighth of their income into a Social Security system that is likely to yield a real return of less than 1.7 percent on their contributions. Moreover, it will influence the life of people, perhaps not yet born, who quite possibly could become employed by a business that is created by the retirement investment of the young high-income New York couple.

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[22] These amounts differ from the amount a lifetime income investment of their savings will generate because they do not include interest on these amounts following retirement or the income taxes paid on them when they are drawn down by the retired couple.

[23] In 1996, a little under 14.5 percent of all OASDI tax and interest receipts was added to the OASDI trust funds. See Social Security Trustees Report, Table II, C1.

[24] See Michael Tanner, "Public Opinion and Social Security Privatization," Cato Project on Social Security Privatization S.S.P. No. 5, August 6, 1996.

[25] Based on an interest rate of 2.7 percent and a lifetime expectancy of 15 years.

For almost every type of worker and family, retirement under Social Security means receiving fewer dollars in old age and passing on less wealth to the next generation than they could if allowed to place their current Social Security tax dollars in private retirement investments.

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APPENDIX

BASIC ASSUMPTIONS AND METHODOLOGY

The authors used The Heritage Foundation's Social Security Rate of Return Microsimulation Model to compare the benefits different types of families can expect to receive from the Old-Age and Survivors Insurance (OASI) with the Social Security taxes they pay during their working lives.

The Heritage model treats taxes paid over a worker's lifetime as a series of investments. Social Security's rate of return is the rate of return on payroll taxes that would buy an annuity equal in value to the Social Security benefits payments. This yield is the difference between Old-Age and Survivors benefits payments (after subtracting any applicable income taxes) and the amounts paid to the Old-Age and Survivors Insurance trust fund through payroll taxes. Throughout the model and this paper, all amounts are adjusted for inflation and expressed in terms of 1997 purchasing power.

The Heritage Foundation model includes both portions of Old-Age and Survivors Insurance taxes: the share paid by employers and the share paid directly by the employee. However, in calculating the return, an amount is removed from taxes paid that is equal to the premium on a term life insurance policy which has the same value as benefits that are paid to children of workers (and the spouse caring for their children) who die before retirement. This means the calculations do not unfairly include the cost of the spousal benefit when figuring the rate of return in terms of retirement income. Heritage analysts also assume that, from 2015, tax rates will increase by the amount that the Board of Trustees of the Social Security Administration consider to be necessary to finance the Old-Age and Survivors Insurance benefits contained in current law.

The earnings to which OASI tax rates are applied are based on a proportion of the Social Security Administration's Average Wage Index. Average-income workers are assumed to earn 100 percent of this wage, and low-income workers are assumed to earn 50 percent of this wage. Past values of this wage are taken from historical data contained in the Board of Trustees' 1997 Annual Report, and future wage growth is based on the Trustees' best guess of what the rate of increase in the average wage will be. All workers are assumed to begin work on their 21st birthday and to continue to work right up to the age on which they become entitled to Social Security's full Old-Age and Survivors benefit. For those retiring in 1997, this is age 65; but under current law, this retirement age is scheduled to increase gradually until reaching 67 for those born in 1960 and later.

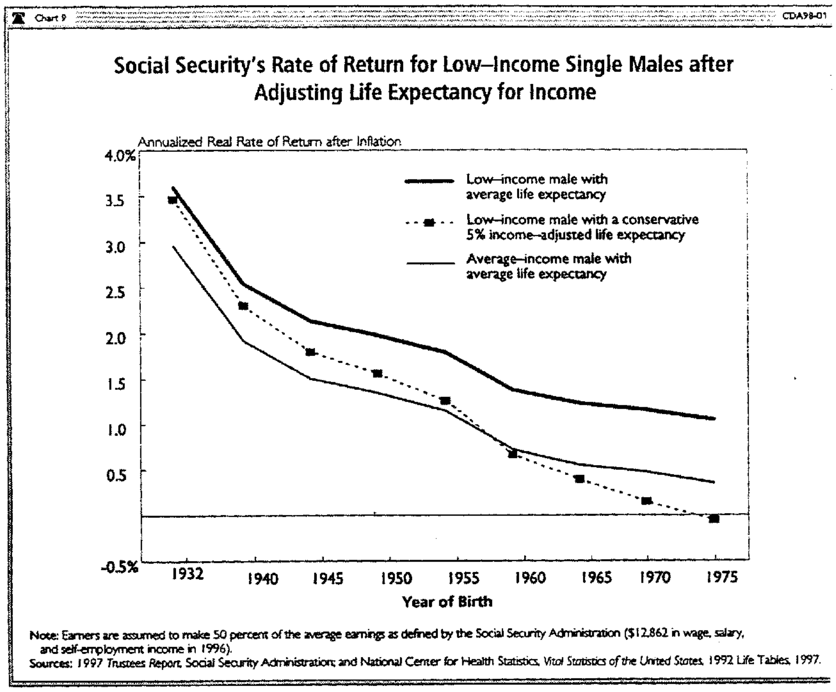
The model calculates post-retirement Old-Age and Survivors benefits to individuals according to formulae stipulated in current law and the "best guess" economic assumptions contained in the 1997 Annual Report of the Board of Trustees, up to the date on which their life expectancy expires. Neither Disability Insurance taxes nor benefits are included in the model.

The model uses life expectancies drawn from the National Center for Health Statistics' 1992 Life Tables for the United States.[26] Heritage analysts adjusted these life tables for future changes in life expectancy, using the mid-range projections of the 1997 Trustees Report. For African-Americans, a "convergence factor" is included that assumes, in line with U.S. Census Bureau projections, that African-American life expectancy converges with that of the general U.S. population by 2070.[27] Income itself plays a role in influencing life expectancy: For example, access to health care and nutrition improves as income rises. Heritage analysts incorporated this influence by increasing the life expectancy of both spouses in line with scientific evidence for workers who earned more than the average wage. However, they did not de-

[26] National Center for Health Statistics, Vital Statistics of the United States, 1992 Life Tables, Vol. II, Section 6, 1997.

[27] This estimate has been criticized as too optimistic. Analysts have pointed out that life expectancy data since the late 1980s have shown little evidence of racial convergence. Indeed, some claim that the gap is widening. See Paul E. Zopf, Jr., Mortality Patterns and Trends in the United States (Westport, Conn.: Greenwood Press, 1992).

crease life expectancy for workers who earned less than the average wage. The possible effect of decreased life expectancy due to poverty on the rates of return experienced by low-income individuals can be seen in Chart 9.



Statistical studies [28] have estimated that for males who earn 50 percent of the average income, their remaining life expectancy is lowered by a factor of between 5.6 percent and 12.8 percent. Even if the most conservative assumption (5.6 percent) is used to adjust the life expectancy of a low-income single male, the result would be a substantial reduction in his rate of return from Social Security.[29]

Throughout this study, comparisons are made between what families could accumulate during their working lives if they were able to invest their Social Security Old-Age and Survivors taxes (less the life insurance premium equal to the value of pre-retirement Survivors Insurance benefits) and what they can expect to receive, on average, in Old-Age and Survivors benefits. Different assumptions are entertained regarding the composition of the worker's portfolio of private investments. For years prior to 1997, the historical inflation-adjusted rates of return on long-term U.S. Treasury bills [30] and U.S. equities [31] are used to determine, respectively, the rate of return on bonds and the rate of return on equities. For the period 1997 onwards, Heritage analysts used forecasts of the real rates of return on 30-year long-term U.S. Treasury bonds to estimate returns on bond investments. These forecasts were made by WEFA, Inc., an economics consulting firm, and published in its Long-Term Macroeconomic Forecast for October 1997.[32] The eventual long-run average of

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[28] For an analysis of the effects of income on life expectancy, see E. Rogot, P. Sorlie, and N. Johnson, "Life Expectancy by Employment Status, Income, and Education in the National Longitudinal Mortality Study," Public Health Reports 107CH, July-August 1992, pp. 457–461, and J. Duggan, R. Gillingham, and J. Greenless, "The Returns Paid to Early Social Security Cohorts," U.S. Treasury Department, Office of the Assistant Secretary for Economic Policy, 1993.

[29] As well as an undermining of the "progressivity" of the current system.

[30] Based on the real rate of return for long-term U.S. Treasury bills. The Federal Reserve Board's 10-to 15-year Treasury Bond Index is used from 1950 to 1975; the 20-year Treasury Bond is used in 1976. From 1977 on, the 30-year bond is used.

[31] Based on the real rate of return for the Standard and Poors' 500 Equity Index.

[32] WEFA, Inc., formerly known as Wharton Econometric Forecasting Associates, is an internationally recognized economics consulting firm. Fortune 500 companies and prominent government agencies use WEFA's forecasts and consulting products.

these forecasts is a 2.8 percent real rate of return. The annualized real rate of return on equities is assumed to be 5.7 percent, which lies at the lower boundary of professional estimates of the long-run returns to equities.[33]

THE HERITAGE FOUNDATION SOCIAL SECURITY RATE OF RETURN MICROSIMULATION MODEL

The Heritage Foundation Social Security Rate of Return Microsimulation Model computes the expected annualized rate of return from Social Security on the basis of the taxes that individuals or couples are projected to pay and the benefits they can expect to receive during their lifetime. The focus of the model is not to provide estimates of the "average" rates of return to existing populations, but rather to use data to construct representative individual and family types and to estimate the rates of return that those representative types can expect to receive.

Internal Rate of Return

The internal rate of return is defined as the rate which will set the expected discounted value of the stream of Social Security Old-Age and Survivors Insurance tax payments (i.e., taxes [T_i]) equal to the expected discounted stream of income from the system (i.e., benefits [B_i]).

DISCOUNT RATE:

r is the discount rate such that:

$$\sum_{t=1}^{i} \frac{E(T_i)}{(1+r)^i} = \sum_{t=1}^{i} \frac{E(B_i)}{(1+r)^i}$$

TAXES:

The taxes paid by an individual are calculated by multiplying the individual's taxable earnings and self-employment income in a given year by the Old-Age and Survivors Insurance (OASI) tax rate in that year. Each individual is assumed to begin work on his or her 21st birthday and to cease working on the date on which he or she is entitled by law to collect the full Social Security Old-Age benefit. The OASI tax rate is taken from current law until the year 2015, after which tax rates are adjusted annually so that income and expenditures of the Old-Age and Survivors Insurance program are equal.[34]

The tax revenue in a given year is calculated by means of multiplying the earnings for that person by the OASI tax rate

$T_i = x_i{*}W_i - L_i$

where x is the OASI tax rate for year i, W_i is the total taxable wage, salary, and self-employment income for year i; and L_i is an amount equivalent to the value of a life insurance premium equal to the actuarial value of pre-retirement Survivors Insurance coverage.

Earnings

The individual's annual earnings are assumed to be a fixed proportion of Social Security's "Average Wage Index"[35] for employed and self-employed workers.

"Average-income" individuals are assumed to earn 100 percent of the average wage index during their lifetime; "low-income" individuals are assumed to earn 50 percent of the population's average wage; and "high-income" individuals are assumed to earn 300 percent of the average wage. In 1996, the value of these amounts was estimated to be, respectively, $12,862, $25,723, and $77,169.[36]

For periods subsequent to 1996, the average wage index is assumed to grow at the rate assumed under the "intermediate" projections made by the Social Security Board of Trustees in their 1997 Annual Report.[37] In the case of the "Single-Earner

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[33] The 1994–1996 Social Security Advisory Committee, for example, found that a long-run real rate of return on equities of 7 percent existed. Report of the 1994–1996 Advisory Council on Social Security, Vol. I: Findings and Recommendations, p. 35.

[34] These tax rates are calculated using the intermediate assumptions in the 1997 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Fund.

[35] As defined in the 1997 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Fund, p. 208.

[36] Ibid., Table II.E.2.

[37] Ibid.

Married Couple" scenario, it is assumed that one spouse pays no OASI taxes during his or her lifetime. In the case of the "Double-Earner Married" couple scenario, each earner is assumed to pay OASI taxes.

Post-Retirement Old-Age and Survivors Benefits

OASI benefits are calculated on the basis of the "bend point" formulae—the earnings levels from which benefit amounts are calculated—as specified under current law. For example, in order to calculate the monthly benefit amount for an individual who first becomes eligible for full Social Security Old-Age Benefits in 1995, the individual's Average Indexed Monthly Earnings (AIME) is calculated according to the formulae contained in current law. Individuals receiving benefits for the first time in 1997 are paid 90 percent of their AIME up to the $437 bend point, 32 percent of any earnings between the $437 and $2,635 bend points, and 15 percent of any amount in excess of $2,635 (up to the maximum amount of earnings which are taxable). For years after 1997, these bend points are indexed at rates in the "intermediate" range projections made in the 1997 Trustee's Report.

Benefits are paid up to the point of the individual's life expectancy. These tables are adjusted to fully incorporate the effect of changes in life expectancy that are estimated by the Trustees of the Social Security Trust Funds to occur over the period 1993–2070.

Survivors Insurance

For married couples, the value of pre-retirement Survivors Insurance—paid to children of deceased covered workers and the spouse taking care of them—is approximated by subtracting from taxes (T_i) the premium required to buy an equivalent term life insurance policy. Covered individuals are assumed to carry two 10-year term life insurance policies over 20 years between the ages of 35 and 55. For each covered worker turning 35 in 1997 who has two children and earns an average wage, the Survivors Insurance policy is estimated to be equivalent to a 10-year term life insurance policy worth $295,000. For each average-wage covered worker with two children who turns 45 in 1997, the Survivors Insurance policy is assumed to be equivalent to a 10-year term life insurance policy worth $194,700. The market insurance annual premiums required to buy every $250,000 worth of insurance (in 1997) were estimated, respectively, to be $167 and $345 for a male and $150 and $230 for a female.[38] The estimates of the life insurance component are indexed to changes in the earner's Primary Insurance Amount,[39] which is used to calculate the worker's retirement benefit.

In the case of the single-earner married couple, each spouse is assumed to be the same age. After retirement, the couple is paid 150 percent of the benefit amount payable to a single beneficiary during the lifetime of the husband. During the period between the death of the husband and the death of the wife, the wife is paid 100 percent of the benefit amount payable to a single recipient.[40]

Life Expectancy

Life expectancy by worker's age in 1992 is estimated based on data contained in the National Center for Health Statistics' 1992 Life Tables.[41] However these estimates reflect only the demographic conditions that prevailed in 1992 and do not reflect the long-term secular upwards trend in life expectancy that improved health care and better nutritional standards will cause.

The Board of Trustees of the Social Security Trust Fund, for example, estimates that between 1997 and 2070 life expectancy at birth will increase by 5.8 years for males and 4.6 years for females, and that life expectancy at age 65 will increase by 3 years for females and 2.9 years for males.[42] In order to create life expectancy projections that embody these projected trends, it is necessary to adjust the 1992 Life Tables.

First, Heritage analysts made a slight adjustment in the 1992 Life Tables by applying to them an age-weighted index that adjusts for the estimated increase in life expectancy over 1992–1997:

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[38] Based on lowest quotes available for contract from Budgetlife's World Wide Web page, www.budgetlife.com, on September 24, 1997.

[39] As defined in the Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Fund, p. 216.

[40] All life expectancy data used in this paper show that women have longer life expectancies than men.

[41] National Center for Health Statistics, Vital Statistics of the United States, 1992 Life Tables, Vol. II, Section 6, 1997.

[42] Ibid.

$Q = E + J,$
and $J = ((O / 65)*S + ((65 - O) / 65)*X)$
where
Q = 1997 "adjusted" static life expectancy;
J = age-weighted increase in life expectancy age between 1992 and 1997;
E = life expectancy based on 1992 "static life tables";
O = age in 1992 (ranges from 16 to 60); and
S and X = respectively, the increase in life expectancy at birth and age 65 over 1992–1997.

Second, Heritage analysts recognized that the gains in life expectancy in the post-1997 period will not be uniform across the age distribution. The Social Security Administration estimates that life expectancy at birth will increase much faster than life expectancy at age 65. In order to calculate the gain in life expectancy for individuals between these two points (birth and 65), an age-weighted index is used:

$G = (A / 73)*B + ((65 - A) / 73)*x'$
where
G = overall gain in life expectancy for a particular age group over 1992–2070;
A = age in 1997 (ranges in model from 21 to 65);
B = gain in life expectancy at birth between 1997 and 2070; and
x' = gain in life expectancy at age 65 between 1997 and 2070.

G can be used to construct a projected life table for the single year 2070, where L is life expectancy for each age group in 1997 and G is the gain in life expectancy expected to occur for that particular age between 1997 and 2070:

$L = Q + G.$

However, this projection must also take into account the fact that life expectancy gains will be distributed over time as well as across the age distribution. The gains in life expectancy projected to occur will be spread across a period between now and 2070. The later a cohort is born, the greater the proportion of this increased longevity will be from where the cohorts can be assumed to benefit. In order to estimate the degree to which a given cohort will benefit from this increase in life expectancy, the following linear weighting equations were used:

"Dynamic" Life Expectancy = $Y + R*(G)$
where
$Y = Q$, or life expectancy in 1997;
$R = ((2070 - V)/73)$; and where
V = year in which the individual's life expectancy expires.

For African-Americans, Heritage analysts added a convergence factor. It is assumed in the model, in accordance with U.S. Census Bureau [43] projections, that African-American life expectancy at birth converges with white life expectancy at birth between 1989 and 2070. This assumption is incorporated by assuming that the gap between African-American and white life expectancy closes by a fixed fraction each year between 1989 and 2080. This convergence factor is assumed to increase with the year in which an individual is born. The gap between African-American and general population life expectancy at birth is assumed to diminish by a factor of 1/154th (or 0.6494 percent) for each birth year between 1927 and 2080. Hence, for each African-American born in 1932, the current gap between life expectancy and general life expectancy is assumed to diminish by 3.25 percent; and for an African-American born in 2080, it is assumed to diminish by 100 percent.

The authors are grateful to Bruce Schobel (Fellow of the Society of Actuaries and formerly with the Social Security Administration) for his valuable suggestions on an early version of this study.

Mr. APFEL. But the issue of African-Americans receiving a lower rate of return which is one of the conclusions of the report is inaccurate, and part of that is the methodology that was used in developing the report. Also, disability benefits were not taken into account. If we look at African-Americans, there is a shorter life expectancy of about 2 years compared to whites. There are also somewhat lower earnings. There is also higher disability program participation as well as survivors benefits.

[43] Zopf, Mortality Patterns, op. cit.

African-Americans make up about 12 percent of the population and receive about 20 percent of survivors and disability benefits. There is a relationship between income and disability, and this is the case with African-Americans, so when you take into account survivors and disability insurance, when you look at the whole floor of protection as well as the progressive nature of the benefit structure, it makes up for the lower life expectancy, so I would like to include this report in the record.

Mrs. KENNELLY. I have another thought, but will follow up in the future. Thank you, sir.

Chairman BUNNING. Mr. Weller.

Mr. WELLER. Thank you, Mr. Chairman, and good afternoon, Commissioner. Good to have you here.

Mr. APFEL. Great to be here.

Mr. WELLER. I represent a fairly diverse district. I represent part of the City of Chicago and the south suburbs in Illinois and also a lot of rural areas, so I always look for the things that are consistent when I'm listening and learning concerns in town meetings. And the questions I always get asked—of course, we all remember that very visual photo of the President drawing the zero on that piece of cardboard when he unveiled his new budget proposal for this year. And, of course, part of that—one the significant things about the zero is it means there's no surplus in his budget to set aside for Social Security. And at the same time, the President unveiled a whole new list of new spending initiatives, and what do they total? The new spending initiatives above and beyond what we've funded this past year.

Mr. APFEL. I'll have to get that.

Mr. WELLER. About $70 billion?

Mr. APFEL. I'll have to get that for the record for you, sir.

[The information follows:]

In his State of the Union Address, the President outlined various areas of investment in his FY 1999 budget:

For families and children, the Administration has proposed a Child Care Initiative that provides tax breaks to help families pay for child care and tax incentives to help businesses create or expand facilities. The initiative seeks also to direct subsidies for poor children and increase and improve after-school programs. The President has also continued his investments in education, with new initiatives to reduce class size, create new education opportunity zones, and expand Head Start.

In health care, the President has worked hard to expand health care coverage and improve the nation's health. This budget provides new options to hundreds of thousands of Americans aged 55 to 65 and proposes initiatives to ensure coverage for children.

Details on the aggregate costs of these and other investments proposed by the President are best asked of the Director of the Office of Management and Budget. I can assure you, however, that these investments are fully paid for. The President's budget continues the discipline that he has shown from the beginning, and complies with all of the requirements of the budget agreement that was entered into last year. In fact, I'm advised that the President is balancing the budget three years earlier than called for in the budget agreement.

The President has asked that the Congress not pursue any tax cuts or new spending unless the proposals meet a very simple test -- and that is that they are paid for. He believes that that is an important discipline, reserving any future budget surpluses until we reach a bipartisan, long-term solution to the solvency of the Social Security trust funds. This is a fundamental part of the President's budget.

Mr. APFEL. As for the Social Security piece—I've got the Social Security piece; I don't have the other pieces on the top of my head, but there were a significant number of very important proposals, all paid for through offsets. One of the things that the President did indicate when he put out his budget request was that—again, given the traditional PAY–GO rules that you operate under here in the Congress—which are appropriate—that any new spending activity be offset through either reductions in spending or increases in revenues, and the President's proposal was consistent with that in terms of living within the budget rules by funding new activities through other offsets.

Mr. WELLER. Now, some might argue that one way of creating a surplus to save Social Security would be to spend less money on new spending initiatives, and as the Social Security Administrator, would you suggest that Congress look at that as an approach? You know, make these new spending initiatives a secondary priority to saving Social Security and creating that surplus that we can then use long term to save Social Security. Which is a bigger priority, the new spending initiatives or saving Social Security?

Mr. APFEL. Well, the President said—and it's something that I strongly support—to take all budget surpluses that are projected and reserve them pending Social Security reform. We anticipate next year to be in a position to, working with this Subcommittee, come up with a proposal to ensure the long-term security of Social Security.

He also proposed a series of activities that were paid for throughout the budget that seem to me to be a legitimate part of government to find ways to pay for new activities by reductions or decreases in other parts——

Mr. WELLER. But these pay-fors that create revenues that are used to offset new spending, if we would take less of those pay-fors to offset new spending and use those pay-fors that, perhaps, the President's suggesting to save Social Security, which is a higher priority for you? Is it a higher priority to save Social Security or spend on new initiatives?

Mr. APFEL. Well, I think the budget proposal does both, and I think that's an appropriate activity. One, it creates the framework, working with the Congress, to reserve the surpluses to create a major incentive to come around the table and save Social Security next year. Two, it also—as every budget always does—reallocates moneys within the budget for different activities which is the tradition of budgeting for years and years, so I think both——

Mr. WELLER. One of the frustrations I hear whether I'm with seniors or 20-year-olds just starting in the work force who are wondering whether or not their contract with Social Security is going to be honored. Is there concern about this time honored tradition that President and Congress have had in the past, and the President does it in his budget this year where they use the surplus in the Social Security Trust Fund to offset new spending. How much—in the President's budget, how much of his new spending is paid for offsets from the Social Security Trust Fund?

Mr. APFEL. How much of the new spending?

Mr. WELLER. Well, how much of the Social Security Trust Fund surplus is used as part of his budget?

Mr. APFEL. If we look over the course of the last 10 and 15 years when we were running significant budget deficits in this country, we were in a hole in economic terms. As of next year, we are now in a position for the first time to finally start digging out from underneath that significant debt problem. That puts us in a much stronger position to take on the Social Security reform issue now in this nation.

Mr. WELLER. If the President's budget did not use the surplus in the Social Security Trust Fund to produce on paper a balanced budget, how large would the deficit be?

Mr. APFEL. The Social Security surpluses in the Social Security Trust Fund are larger than—like this year, the Social Security Trust Fund——

Mr. WELLER. Seven billion dollars? A hundred billion dollars?

Mr. APFEL. The Social Security Trust Fund surplus is projected at almost $100 billion; money comes into the system in terms of both added payroll revenues as well as interest coming into the fund.

Mr. WELLER. So, if you were to remove that $100 billion surplus, we would have a $100 billion deficit in the President's budget.

Mr. APFEL. Well, that would be the—that's the hypothetical. That's correct, sir. The point is that it's one of the reasons why we have argued very strongly about reserving those surpluses. We are now, for the first time, in a position where we're moving into the surplus world where we can, for the first time, start to dig out from the economic problems that we've had in the past several years. We believe that this sets the stage by reserving those surpluses rather than having them go to tax cuts or for added spending that would put us in a deeper hole for dealing with the long-term Social Security issue. So, we believe it's very important that those surpluses be reserved pending the Social Security action that we intend——

Chairman BUNNING. The gentleman's time has expired.

Mr. WELLER. Thank you, Mr. Chairman.

Chairman BUNNING. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman. Commissioner, I was delighted when you, in your opening statement, noted the fact once again, that oftentimes is lost around here, that beginning in 1935 with the inauguration of Social Security that we present this today as the most successful domestic initiative that has ever been undertaken and, indeed, on a contractual basis from generation to generation it gives us a sense of community, and it does tie us together as members of the American family, but—and I also speak to this with some personal experience which we could, perhaps, save for a later day—but I went to college on Social Security. People forget that, and I've never lost contact or respect for this initiative that has given many of us in this nation a chance, sometimes against serious odds.

And the point that I make is that I've been involved with the savings coalition here because I do, indeed, think we can do a better job of educating the American people as to how they prepare for retirement. I think we lose sight of the fact in this debate just what Social Security has accomplished, and I'm troubled by that generation just a bit behind me that looks at Social Security, and they do, obviously, raise questions about whether or not it's going to be there for them. That's understandable, but I also think they, for a variety of reasons, perhaps, have not zeroed in on what Social Security did for millions and millions and millions of Americans and how they've enjoyed their retirement years.

All of us go out campaigning to one religious stop and that's the senior center, and when we go into the senior center I dare say there aren't many of us who say that we ought to curtail Social Security benefits and that we ought to cut back on Social Security initiatives, and we don't engage the grand debate in that room about the merits of Social Security. We subscribe to a basic fact and that is that Social Security has been an extraordinary success, and the people in that room always know it.

But my point is as we begin these discussions about Social Security—and I wish to be part of them—how would you, if you were to suggest things because I'm sure you've had discussions about it—how would you talk about establishing a higher retirement age? How would you begin that process? What would you say if you were drafting the parameters of that discussion? How would you point out to the American people that because of life expectancy and a host of other things that people do, indeed, live longer? How would you frame that discussion?

Mr. APFEL. Before answering the retirement age question, I want to comment on your opening remarks which I think are very, very powerful. One of things that we need to educate the American public about this year is the importance of Social Security in our lives. Back in 1935, the plight of older Americans was a national disgrace, and Social Security provided an enormous platform for older Americans. It's true for young Americans today that there is a serious concern out there. I think one of the ways that we address the retirement age issue and many of the other issues that we face is by acknowledging that we have a long-term demographic issue that we need to confront in this country and how it will create great strains on our social insurance system.

And the question for young people is will Social Security be there in the future? And the answer is, absolutely, it's going to be there in the future, but it's going to have to go through some changes. We're going to have to make some changes. As you pointed out about going to college, my wife, when she was a little girl her father died leaving her mother and three sisters with a Social Security check. It is part of the foundation of American life. It's part of our fabric. So for young Americans, it's not only a question of whether Social Security is going to be there 30 and 40 years from now, it's also a question of whether it is there now? And it is, but given those demographic issues—those long-term demographic issues—we've got some tough choices to make to assure that we will have a foundation of support for all Americans in the future.

And one of the issues that's got to be discussed as part of that is whether—given the fact that life expectancy has increased—whether people should be working longer. As the Chairman said, I think eloquently, there are tradeoffs to every one of the options that we confront, and on the retirement age, there's a whole series of them that have to be thought through very carefully: Whether there will be jobs for older Americans; whether the people who are working in physically demanding jobs will be able to continue to work; what the implications for the disability system will be. Those are some of the issues that we'll have to think through, but is raising the retirement age one of the legitimate issues that we've got to think through to assure that we can have in the 21st century this foundation of support? I think the answer is yes, and this will be one of the ones that we'll have to talk through very carefully.

Mr. NEAL. For my family, for my sisters and I, it was $119 a month, but it was the difference between that and an orphanage. We lose sight of that here.

Mr. APFEL. Very powerful.

Mr. NEAL. I would also like to close on this comment—I thank the Chairman for the time—I think William Buckley, that sage of liberal thought, summed up the best when he said conservatives hate the new deal; they just don't want to give it up.

Mr. APFEL. Thank you, sir.

Chairman BUNNING. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman. Commissioner, you're right, there are a lot of people in—Mr. Neal, you're right—there are a lot of people who have benefited greatly from the Social Security Program, and it's one that will be here for, I assume, as long as we have a Republic. There will have to be changes made to it. I'm very much concerned of the fact that some people would like to extend the age for retirement. It's kind of like moving the goal line once the game has begun, so I have great concerns over that.

I have a little bit of a difference of opinion as to how the Social Security actually came about. It was during the time of the Depression, before my time, but both of my parents lived during that time, and we're trying to raise families. But, to me, it was a payroll tax sold under the disguise of an old-age pension program. Had it been a true old-age pension program, I think a lot of those contributions to the fund would have drawn some type of return, such as a compounded interest or some type of return on the investment, rather than just being put into the pool, and the government use those funds at will, and then made the benefits when the time came of eligibility. So I differ somewhat with why and how Social Security came about.

That's the reason I think a lot of our young people today are very much interested in seeing a change that would allow the funds that they contribute to be able to have a return to them based on that vested interest of that money that's deducted. It would be compound interest on a daily basis through interest. So I think there are a lot of changes and a lot of things that we're going to be looking at over the next few months or a couple of years when it comes to Social Security.

In 1995, the President was at Warm Springs, Georgia, the country home or the little White House of Franklin Delano Roosevelt, and he and I were standing there in the little White House having a farewell discussion, and we had been together for a couple of hours that day, and as he was going to fly back to Washington, I was going to stay there in my district. And I told him, I said, "Mr. President, I want to leave you with thought, and that is, Social Security is my old-age pension." And I say it again, Social Security is my old-age pension. I turned down the congressional pension. My small business doesn't have a pension program. I have an IRA, and Social Security is my old-age pension.

But, really, Social Security has been a payroll tax on me for a number of years—with only the return based on the benefits that Congress will set, not what it drew based on my deposits, and a return on those deposits, or how my family would benefit from those deposits based on the return on those deposits.

Thank you for your time.

Chairman BUNNING. Mr. Levin.

Mr. LEVIN. Welcome. I'm sorry I missed your testimony, but I did have a chance to read it, Mr. Apfel. Your career has been an outstanding one, and we're glad you're where you are.

Mr. Collins—I wasn't going to raise this, but just so the record's clear. Isn't it correct, Mr. Apfel, that for those who have retired up until now who have been drawing benefits, they by and large have been receiving back far more than they put into the fund?

Mr. APFEL. Yes, that's true.

Mr. COLLINS. Will the gentleman yield on that?

Mr. LEVIN. Yes.

Mr. COLLINS. But is it not also true that, as time has changed and the rate of taxes changed, it will also take longer for those who are young today to receive their benefits back?

Mr. APFEL. That is true also. The early years of the social——

Mr. COLLINS. We understand where you're coming from, but it does not take away from my view that it was a payroll tax and not a true pension program from the beginning, and I thank you for yielding.

Mr. LEVIN. Except it was an insurance program that has paid back recipients up to this point on the average considerably more than they put in, even if you would add a compounding factor. And the problem we face now is what Mr. Apfel has pointed out and the President has pointed out: That people are living much longer, and we're facing a problem ahead from the baby boomers, and those who are younger ask the question: Are they going to not receive a pension, and Social Security? Under any circumstances a considerable portion of their benefit would be there, but whether all of the benefit could be there, plus essentially a growth factor, as has been true for most of those who have received Social Security up until now, is the issue confronting us. They've had a growth factor, haven't they?

Mr. APFEL. Yes.

Mr. LEVIN. And that's the dilemma that we face and that we need to solve, it seems to me, together. And I think, isn't it true, Mr. Apfel, that's one reason the President has suggested that we not expend any surplus coming from Social Security until we solve the long-range problem? Isn't that exactly what's motivating the President?

Mr. APFEL. That is absolutely what's motivating the President. This is the most important government program in the nation's history. There is no crisis today, but we do face a long-term issue that we need to confront, and that this Subcommittee has been in the leadership position. This is your eighth hearing, my first before you, but there will be many opportunities, I'm sure, in the future. We've got to take actions in the future to assure the long-term security of the Social Security system.

The goal of the President, by reserving the surpluses, calling for the year of discussion, and then bipartisan negotiations next January, is aimed at resolving this issue next year, to increase public confidence that Social Security will be there for future generations by those actions.

Chairman BUNNING. Sandy, would you yield just a minute?

Mr. LEVIN. Yes.

Chairman BUNNING. So there's no misunderstanding what you asked and what you said, you didn't say the surpluses in Social Security, as I heard you say; you didn't mean that?

Mr. LEVIN. No.

Chairman BUNNING. You meant the surpluses, if there is any, in the overall budget.

Mr. LEVIN. I think what I said was, the surplus that has come from Social Security. Part of the reason the deficit surplus issue would be different, if one did not take into account the present surplus in Social Security, more coming in than paid out——

Chairman BUNNING. That's correct.

Mr. LEVIN [continuing]. What the President has been saying, as I understand it, is the budget, the overall budget, is affected by the present surplus coming from Social Security. It's projected we would not have one if it weren't for that surplus, we wouldn't have an overall surplus in the unified budget. We should not take any of that proposed surplus and spend it on other programs until we have a long-term solution to Social Security. Isn't that what the President is saying?

Mr. APFEL. Yes, sir. The——

Chairman BUNNING. No, I can't believe that because—and I don't want to get into a three-way discussion with you—for the simple reason it's all recycled into new debt, every penny that comes in in the Social Security Trust Fund is recycled by selling out bonds into new debt in the Uniform Budget.

I think the President's statement was the exact opposite. He said, when we get to a surplus in the overall budget—we're in a surplus; we've been in one in the Social Security Trust Fund for years. It's about $700 billion.

Mr. LEVIN. And that's exactly what I said, Mr. Chairman. That's exactly what I said—that the surplus in the Unified Budget exists, when it comes, it will exist, reflecting the surplus in Social Security, and therefore, before we spend any of the surplus in the Unified Budget on any other programs, we ought to solve the long-term problem for Social Security. Isn't that——

Mr. APFEL. And there may be uses for that surplus at that point in time for Social Security, but that's really what part of the debate is about over the course of this next year.

Chairman BUNNING. Sandy, I'll give you as much time as you want, but the fact of the matter is that when we bring money into the trust funds now, the law requires us to buy nonnegotiable bonds, which in turn are used for spending under the budget right now.

Mr. LEVIN. I'm not saying——

Chairman BUNNING. No, no, no, but——

Mr. LEVIN [continuing]. Anything different.

Chairman BUNNING [continuing]. The surplus that the President talked about was the surplus in the overall budget——

Mr. APFEL. The Unified Budget.

Mr. LEVIN. Right.

Chairman BUNNING. And so he didn't propose any changes. I asked you earlier—any changes in the law as far as the FICA tax. We're going to still spend that money.

Mr. APFEL. We do not think that there is, as I said, a need for a law change right now——

Chairman BUNNING. Yes, until we get to a surplus.

Mr. APFEL. Well, because we're not going to see that surplus right now projected until the end of next fiscal year——

Chairman BUNNING. Well, that's debatable——

Mr. APFEL [continuing]. And by that time——

Chairman BUNNING [continuing]. Also, but I'm not going to get into that debate with you, either, because, according to which scorekeeper you get, Congressional Budget Office or Office of Management and Budget, you get different numbers. So we shouldn't debate that because we'll find out.

Mr. LEVIN. But whatever the number is, I think the fact remains that the Unified Budget, to the extent there's a surplus, reflects the surplus coming in through Social Security, and the President is saying, solve the long-term problem before we use that surplus for any other purpose.

Chairman BUNNING. Mr. Portman.

Mr. PORTMAN. Mr. Commissioner, thank you for being here today, and I'd like to nominate Sandy Levin for President because I think he has explained this problem in a way that the American people need to hear it, and that's not what I heard the President say, incidentally, at the State of the Union, nor in his follow-up press conferences and other communications, either from Director Raines or from Deputy Secretary Summers yesterday. I think Sandy Levin has it just right, which is, in fact, there is not only a pay-as-you-go system, and we need to explain that to the American people, but there's also a trust fund which is being borrowed against every day, and without that trust fund surplus, we would have no balanced budget this year, should we have one.

So I think your formulation is exactly right, but that's not what I've heard our President say to the American people, nor, when you talk, as we did yesterday, and Jim Bunning asked the question to the administration—in this case it was the Deputy Secretary of the Treasury—you know, they still haven't, frankly, figured out what he means in terms of the mechanics of it. Save Social Security first is very popular, and I think all of us would agree with it, but the question is: Do you do it through the Unified Budget or do you do it somehow with the trust fund? I'm sort of intrigued by what I infer from what you're saying, Mr. Levin, which is that maybe we should focus more on that trust fund and look at it in the way it, in fact, does operate, which is to say that, without it, we would have no budget surplus this year. In fact, we're in a deficit position, if it was properly accounted for, and maybe we ought to look at the surplus, whether it's the $70 billion or whether it's the $90 billion that we'll accumulate this year alone, and start working through that as our vehicle to save Social Security.

Mr. LEVIN. Would the gentleman yield?

Mr. PORTMAN. So I'd be happy to yield. I do have a couple of questions for the Commissioners, but sure.

Mr. LEVIN. I think that's what the President is saying, that while there is a present surplus when you look out over a number of years, a surplus in Social Security, that gets eaten up. So you don't want to use that surplus until you make the long-term decisions on financing Social Security.

Mr. PORTMAN. Again, reclaiming my time, maybe I haven't been as attentive as others in this room have been, but I certainly have not heard our President talk in those terms, and I wish he would, because honestly I think that the top priority right now is to educate the American people as to what the reality is with Social Security. And part of it, as I said earlier, is that it's a pay-as-you-go system, and with the demographic shift, you're going to have a problem, and the train wreck can be avoided if we begin to take steps now. I wish he had said that in the State of the Union.

The second part is the trust fund that you've just explained, which I think is the reality, again, that at least my constituents aren't aware of, and I think the President could play an important role there.

Let me ask you a specific question on that, I, unfortunately, was not able to be here for your testimony also, and I apologize. Unlike Mr. Levin, I didn't read it in advance, but I did skim it when I got here, and it's very good. And you talk about these conferences the President's holding around the country with AARP, the Concord Coalition. We're doing one in my district that I'm involved with—I think probably every congressional district. And we have the White House Conference, as you talk about, and you mentioned some other potential forums where the President would be talking about this issue, including a White House Conference with the Congress sometime in early 1999.

Is the Social Security Administration involved in these conferences around the country? Are you directly involved in giving input to the White House as we go through this process?

Mr. APFEL. Yes. In terms of the conferences, directly involved with both the AARP and Concord Coalition, because those forums are going to be theirs. I've also been in contact with Pew Charitable Trusts. As you know, the Pew Charitable Trusts is going to be doing several forums around the country. I'll be attending several of those as well.

The Social Security Administration will be part of this debate. I have been actively involved through the last 4 or 5 months, since my confirmation. I've been around the country many times already. I intend to be involved over the course of this year. The Social Security Administration as a whole will also be involved actively with our public affairs offices in the public discussions. We want to be able to talk to the American people about the importance of Social Security, the fact that there are the long-term issues that we need to confront, and that we need to move forward on them. It's one of the roles and responsibilities that I view as central to the Social Security Administration.

Mr. PORTMAN. So you will have a specific role in these regional conferences as a participant?

Mr. APFEL. I don't know about each and every one, but I know many of them. I'll be traveling outside more than I would like, in terms of going around the country and being away from my family, for them, but I think it's very important that I be centrally involved.

Mr. PORTMAN. I think it's essential that Social Security is directly involved.

Let me ask one other specific question, because I see my time is running out, and that is with regard to the earnings limit. As I looked through your testimony—and perhaps I missed some earlier dialog on this—I didn't see it touch on the question of the earnings limit. In my view, it's directly related to all questions about Social Security, because I think the earnings limit has a perverse effect on our economy and on our seniors.

But, specifically, to the age issue, because, as I understand the way the earnings limit works, once you're over the age of 70, it would no longer apply. If we're talking about raising the age on Social Security, and as you point out in your testimony, of course, it's already being raised incrementally in a steady, but slow fashion, what is your recommendation with regard to the earnings limit? I suppose if you raise the age to 70, there would be no earnings limit, to take it out logically to the logical extension, but should the earnings limit be changed as you change the age limit, either as under current law or in a more aggressive fashion?

Mr. APFEL. If I could back up first and indicate, again, on the President's proposal, I believe he has been very clear that we would preserve those surpluses pending Social Security reform——

Mr. PORTMAN. Which surpluses?

Mr. APFEL. The Unified Budget surpluses pending——

Mr. PORTMAN. OK, that's what I've heard, too.

Mr. APFEL [continuing]. Pending Social Security reform; that the decision as to the particular use of those surpluses within the Social Security system is one that needs to be debated this year. Some have proposed investing some of those surpluses in equities. Some have proposed providing them to the Social Security Trust Fund. Some have proposed individual accounts. These are all things that need to be debated this year. So I think the policy is very clear, and we do hope on a bipartisan basis to work together to develop what I think is a very important thing for the American public, which is next year a proposal to assure long-term security for Social Security.

On the earnings limit issue, I think it is an important one. The administration worked with the Congress to raise the earnings limit to $30,000 by the year 2002.

One of the issues that would have to be addressed in terms of raising it further or eliminating it altogether is the short-term cost. The cost of that would be about $4 or $5 billion a year. There are not long-term costs for eliminating the earnings limit cap, because of the way that the delayed retirement credit works, but there are short-term costs that would have to be taken into account. So is it something that should be considered as part of the overall reform efforts? I would say that it absolutely should be considered. The administration does not have a position one way or the other on it, again, because we want to see the entire package, working with the Congress, to see how each of the individual pieces would fit in together.

Mr. PORTMAN. My time's up, but the point I was making was the interaction between the age issue, so you might want to——

Chairman BUNNING. Thank you, Mr. Portman. Your time has expired.

Mr. PORTMAN. Thank you, Mr. Chairman.

Chairman BUNNING. Thank you, Commissioner. I have no more questions for you. I don't know if anybody else does.

Mr. NEAL. Do you want to go through again what the President said once more? [Laughter.]

Chairman BUNNING. I think he said it very clearly, what he said in his last statement.

Thank you very much.

Mr. APFEL. It's an honor to be here, sir.

Chairman BUNNING. Commissioner, we may be submitting additional questions in writing for you to answer for the record. We appreciate your testifying.

[Questions were submitted by Chairman Bunning to Mr. Apfel. The questions and responses follow:]

1. You mention in your testimony that the Greenspan Commission (who made their recommendations 15 years ago) suggested that changes should be made in the disability benefits program to take account of those older workers who are unable to extend their worklives for health reasons. What research have you completed on this issue. Are you prepared to submit a legislative remedy?

Much of the SSA research that addresses the general issue of raising the retirement age (see question 4) seeks to estimate the size of the group whose health problems make further work difficult or to better understand the relationship between ill health and retirement.

While SSA has not conducted separate studies of how particular changes in the disability insurance program might interact with retirement age increases, SSA has undertaken the collection and development of information to support analyses of disability program modifications. For example, SSA has created a microsimulation model of the Social Security (OASDI) program, with an initial focus on the disability program. (The model is based on a linkage of Social Security records to the Survey of Income and Program Participation.) Estimates from the project show that a substantial minority (17–30 percent depending on the indicator) of OASI beneficiaries aged 62–64 report significant health problems. When completed, the model will give SSA the capability to analyze distributional and behavioral effects of the current program and proposed alternatives.

SSA is also designing the Disability Evaluation Study (DES), which combines survey reports, clinical examinations, and medical evidence of record so that we can make accurate determinations of disability rates throughout the general population. The DES is carefully designed to include workers up to age 69 so that we can assess alternative retirement ages and alternative disability standards for specific age groups. Also underway is a literature review and analysis of vocational factors of age, education, and work experience; results of that project will help frame the problem of older workers unable to extend their working lives. SSA also supported the special disability data collection of the Health Interview Survey and supports the Health and Retirement Survey. Both of these databases allow study of disabilities and health problems of older workers.

Changes to the disability program to take account of increases in the retirement age need to be consolidated in the context of Social Security reform. As with any possible element of a solvency solution, such changes must be developed in a bipartisan manner and reflect, insofar as is possible, a consensus of the American people. To this end, this year has been dedicated to a national dialogue on Social Security solvency. The Agency has participated in over 5,000 events and media opportunities, including town hall meetings and other public events. The ideas that flow from this process should equip the Administration and the Congress with a firm foundation on which to build together a bipartisan legislative agreement. Without the benefit of this debate on these critical issues, it would be premature to submit legislative remedies.

2. Your testimony mentioned nothing about the senior earnings limit, the amount of wages seniors can earn before their benefits are offset. Have you thought about the effects of increasing the retirement age on the earnings limit? Do we continue to need to penalize seniors for trying to be productive?

As you know, present law provides two different earnings tests, one for beneficiaries who have reached normal retirement age and another for those who have not.

The Administration supported the 1996 legislation which roughly tripled the earnings test to $30,000, by 2002, the amount that beneficiaries who have reached normal retirement age can earn before their benefits are reduced. In doing so, the Administration noted that “Raising the earnings test will increase the standard of living of the elderly and help the Nation’s economy by increasing the supply of workers to the labor force.” One of the issues that needs to be considered as part of the solvency debate is whether further changes are warranted.

As normal retirement age increases, the number of beneficiaries subject to the earnings test that applies before normal retirement age will increase. However, there are issues that need to be considered with regard to liberalizing the earnings test for beneficiaries who have not yet reached normal retirement age. Doing so could encourage workers to file at age 62, even though they are still working (i.e., when they may not be as dependent on Social Security benefits) and receive permanently reduced benefits. These permanently reduced benefits may be inadequate to support them in later years when they are unable to work.

Today, workers retiring at age 62 have their benefits reduced by 20 percent. The amount of this reduction will increase as normal retirement age increases, reaching 30 percent when normal retirement age reaches age 67.

3. You say you want Americans to understand the facts about Social Security, that the trust funds will start declining in 2021 and will be depleted by 2029. What about the fact that outgo exceeds revenues in 2013? Shouldn't Americans understand that as of 2013 the government is going to have to begin paying back the money it owes the trust funds and what that will mean to the federal budget?

I agree that the 2013 date is also very important. In 2013, OASDI expenditures will begin to exceed annual tax revenues. At that time, some of the interest income on the trust funds will be needed to pay benefits. It is correct that using trust fund interest income to pay benefits, rather than to purchase Treasury securities, will have a negative impact on the federal budget.

However, in the President's Budget, which was submitted in February, the Office of Management and Budget projects that the operating budget—that is, the budget not including Social Security—will be in surplus by 2007, six years ahead of the 2013 date. As a result, by the time the trust funds need to use interest income for benefit payments, the rest of the budget will no longer be reliant on those trust funds. This is why it is so important to continue to pursue a course of fiscal discipline. By doing so, we will be better able to respond to the challenges associated with the retirement of the Baby Boomer generation.

4. What research has the Social Security Administration completed on the issue of raising the retirement age?

The work and retirement decisions of older workers have been extensively studied. A considerable amount of this research (listed below) was conducted at the Social Security Administration, or was funded by the Agency. Retirement research has carefully documented long-term trends in the American work force, identified many of the likely determinants of those trends, and estimated the size of the effects of specific causal factors. The retirement literature was reviewed and summarized in a 1996 Social Security Bulletin article (Vol. 59, No. 4, Pp. 2950).

The labor force participation rates of men aged 55 or older steadily declined from the early 1940s until the mid-1980s. During the past decade participation rates have risen slightly (i.e., 1–3 percentage points) for some age groups, particularly among men 65 and older. The rate of decline in propensity to work at older ages was particularly pronounced during the 1970s and early 1980s. The main impetus appears to have been the increased ability of older men to afford to retire at earlier ages. Growth in lifetime real incomes has enabled men to finance increased consumption of goods and services and earlier retirements. Much research has shown that the availability of Social Security benefits and private pensions have been important influences in the trend for men to retire at younger ages.

Many of the retirement studies have focused on the specific retirement incentives associated with Social Security and private pensions. To the extent that Social Security has caused individuals to accumulate more assets to finance retirement than they would have saved in the absence of the program, then Social Security has been at least partly responsible for the trend to earlier retirement. The best evidence suggests that Social Security benefit levels have been responsible for no more than a quarter of the decline in older men's labor force participation rates.

Nearly all retirement research has studied the behavior of men. Much less is known about women's retirement decisions. The labor market activity of older married women appears to respond positively to earnings opportunities, but is less responsive to the availability of unearned income and wealth than is the case for older men. Their retirement decisions appear to be very much influenced by the retirement status of their husbands. The labor supply of unmarried older women is responsive to financial incentives such as wage offers, unearned income, and wealth, including increases in Social Security wealth through additional earnings. Because of the large changes over time in the extent of women's lifetime labor force attachment, these findings should be confirmed with data on more recent retirees.

Research has examined specific administrative features of the retirement program to discern which Social Security elements might be responsible for particular features of observed retirement patterns (e.g., the popularity of retirement at ages 62 and 65). Benefit amounts, the retirement test, the delayed retirement credit, and the early and normal retirement ages have all been scrutinized. The general conclusion has been that the overall effect of Social Security on the average age of retirement is small relative to other factors that influence older workers' labor supply such as pensions, income levels, earnings opportunities, and health. In particular, the influence of Social Security's Normal Retirement Age (NRA) has been estimated to be modest. The evidence from several of the best studies suggests that increasing the NRA by 2 years would, other things equal, probably result in a 2–5 month increase in the average age of retirement.

Until the 1970s, researchers generally believed that health problems caused most retirements. Since then, the view has evolved that most retirements are voluntary and that individuals respond primarily to economic incentives, although health plays a role in inducing some retirements, particularly early ones. Poor health can cause retirement via three links: 1) it can make work more arduous and increase preferences for retirement, 2) it can lower wage offers that the individual can command, and 3) it can decrease life expectancy. The prevalence of work-limiting health conditions among the older population is not well-known, in part because of data limitations.

There is some evidence that health status and capacity to work have been gradually improving since the early 1980s for individuals in their 50s and 60s. This improvement probably reflects many factors including long-term effects of healthier lifestyles adopted by an increasing number of Americans since the1950s, improvements in medical practice, and the lessened physical requirements of many jobs. A large majority of retirees are probably physically capable of working somewhat longer than they have been in recent years. Nonetheless, many individuals—but a distinct minority—have health-related work limitations that will contribute to some hardship if either Social Security's NRA or early retirement age is increased. Much research remains to be done to identify and count this subset of the population, to ascertain the nature of their impairments, (particularly as these health conditions relate to their education levels and work experience), and to determine their socioeconomic and demographic characteristics.

Most of the best retirement research has used data from the Retirement History Study (RHS), a database sponsored by the Social Security Administration beginning in 1969. Thus, much of what we know about retirement is heavily dependent on the retirement behavior of cohorts who retired a couple of decades ago and are currently in their late 80s. To the extent that these cohorts experienced unique circumstances during their lives (surviving the great depression, coming of age during World War II, receiving large real transfers of wealth from the start-up phase of the Social Security system), it is possible that later birth cohorts will react differently to changing circumstances. Therefore, further study of retirement using more recent data on current retirement such as the Health and Retirement Survey (HRS) is greatly needed. In the next several years researchers will have an opportunity to verify many of the findings from the earlier RHS. One key question to address will be whether these later birth cohorts appear to respond to financial incentives any differently than the RHS cohorts. We enter this new phase of retirement research with a provisional view that the effects of Social Security provisions in retirement patterns are probably not very large.

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RESEARCH UNDERWAY OR PLANNED

Several simulation models are being developed to investigate distributional effects of retirement age changes. The models will also simulate effects of simultaneous changes in other program features.

It is expected that the new Retirement Research Consortium will produce short policy analysis papers on the impact of retirement-age increases on the disability program and other critical reform topics. (For the Consortium, cooperative agreements with two universities will be in place by the end of the year.)

The impacts of changes in the early and normal retirement age and the ability of people to work longer given later retirement ages will be assessed. For example, planned studies include the likely effects of raising the early retirement age, focusing on financial asset levels and health and disability patterns of affected workers. Effects on labor supply will also be examined.

Several data development efforts are continuing which provide essential data for analysis of reform proposals. They include the Health and Retirement Survey, the National Longitudinal Surveys of Women, the Survey of Income and Program Participation, and the Survey of Asset and Health Dynamics of the Oldest Old.

Related projects include study of labor force transitions of older workers, projections of the types of Social Security benefits that baby boomer women will receive, and analysis of health status, beneficiary status and employment of persons in their sixties.

Chairman BUNNING. Testifying on the second panel today are Dr. Robert J. Myers, the former Chief Actuary and former Deputy Commissioner, and the institutional memory on Social Security here in the Congress of the United States.

Merton Bernstein is Coles professor of law, emeritus, at Washington University in St. Louis, Missouri.

Dr. Richard Burkhauser is from the Center for Policy Research at Syracuse University in New York.

Ron Gebhardtsbauer is the senior pension fellow at the American Academy of Actuaries.

Dr. Myers, would you please be our first to start? Pull it right over [referring to the microphone] and let it rip.

STATEMENT OF HON. ROBERT J. MYERS, FORMER CHIEF ACTUARY AND FORMER DEPUTY COMMISSIONER, SOCIAL SECURITY ADMINISTRATION; AND FORMER EXECUTIVE DIRECTOR, NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Mr. MYERS. Thank you, Mr. Chairman. I'd like to begin by discussing the definition of "old age." For at least the past half century, this definition in the United States has almost universally been that people age 65 and over are classified as being in old age. The reason for this is that age 65 is the so-called normal retirement age under the Social Security Program as it was originally established, and has been maintained static over the years of operation of the program, although, as you pointed out, in the future, under present law, it is scheduled to rise slowly to age 67 for people reaching that age in 2027.

In my view, the definition of old age should not be a static one, but rather it should reflect changes in longevity, taking into account also work ability and availability of employment. Age 65 was originally selected as the normal retirement age just as a rather arbitrary thing. Age 60 was too low; age 70 seemed too high, and 65 was a nice round figure. I think, as it has worked out, that was a quite good choice. For some people, even particularly back in the early days, age 65 might have been too high an age because of their ability to go on working, but on the whole I think it was a good choice.

However, I think that a mistake in the original planning of the system was that this age would not be indexed in some way or another to increasing longevity. The effect of increasing longevity and continued work ability, of course, is very slow and gradual, but it accumulates to a considerable amount. I believe that, in future years, if longevity rises, so too should the normal retirement age, assuming that work ability also keeps pace, as I believe that it should.

Now if we say that age 65 was right in the beginning, and we say, assuming that were the case, what should it be currently? If we examine for a group of young workers entering the labor force at age 20 and compute based on 1940 mortality what the retirement life expectancy is on the average, and also what the working life expectancy is on the average, and say that the relationship of those two should remain constant, then retirement expectancy is about 21 percent of the worklife expectancy. If that were done based on 1990 mortality, the normal retirement age would now be about 70½, and projecting it ahead a little for today's mortality, that normal retirement age would be 71. So you can see how significant is these slow, gradual increases in longevity.

I think that it may be a case of which comes first, the chicken or the egg, but I think that the fact that the normal retirement age is 65 has had an effect on when people desire to retire, and also on the labor market and on employers' attitudes toward employing older workers. If we had had a gradual increase in the normal retirement age in the past, I think things would look quite a bit different now as far as work ability and work availability are concerned.

The actual schedule for increasing the normal retirement age that was adopted in 1983 was only a small step, in the right direction, but it was very difficult to achieve at that time, and it was done in the right way. It was done on a deferred basis and gradually, and anything that is done about changing the normal retirement age should be something that is gradual, and also something that does not happen too quickly, because it is not fair to people to suddenly change the rules of the game as to when they may retire in the next decade or so.

Very simply, Mr. Chairman, my proposal is that the normal retirement age should be increased, beginning in 2003, just as under present law, by 2 months a year for each year-of-birth cohort. Instead of leveling it off at 66 for 11 years, and then only going to 67, I would increase it indefinitely into the future.

Now this will come perhaps as quite a shock to some people, when I point out what this will do. This means the normal retirement age would reach 70 in the year 2037 and 75 in the year 2074. But I believe that if people are shocked by these ages, it is because they are considering it in a static manner of today's economy and today's demography, and I think that in the future these ages will be reasonable; in fact, they'll probably be less than age 65 was relatively in 1940.

This proposal would reduce the long-range actuarial deficit of the program by approximately two-thirds. The remaining third can be obtained by several minor, relatively noncontroversial amendments, so that the system could be made secure for the future.

Thus, in summary, Mr. Chairman, I believe that the demographic problem of increasing longevity, which causes most of the long-range actuarial deficit, should be solved by demographic means, significantly raising the normal retirement age in a gradual manner over the long run.

Thank you, Mr. Chairman.

[The prepared statement follows:]

Statement of Hon. Robert J. Myers, Former Chief Actuary and Former Deputy Commissioner, Social Security Administration; and Former Executive Director, National Commission on Social Security Reform

Mr. Chairman and Members of the Subcommittee: My name is Robert J. Myers. I served in various actuarial capacities with the Social Security Administration and its predecessor agencies during 1934–70; being Chief Actuary for the last 23 of those years. In 1981–82, I was Deputy Commissioner of Social Security, and in 1982–83, I was Executive Director of the National Commission on Social Security Reform (Greenspan Commission).

MEANING OF CONCEPT OF "OLD-AGE"

Commonly, the concept of "old-age" in the United States is considered as involving all persons aged 65 and over. However, this static basis is not really meaningful over the long run. Certainly, several centuries ago, it would have involved far fewer persons than would have been reasonable. Actually, the concept should be based on longevity and work ability, and thus it should be dynamic over time.

The element of longevity is relatively easy to measure, but this is not the case as to work ability. The latter depends on the ever-changing nature of the labor market and the extent to which employers will adapt their employment practices to the changing abilities of persons as they become older. I believe that, over the years. The possibility of efficient employment of older workers, considering the offsetting effect of long experience as against possibly declining physical ability, will keep pace with increasing longevity. Or, in other words, as people live longer, they should:—and will—be able to work longer. Thus, the definition of where "old-age" is first applicable should be a dynamic one.

WHY AGE 65 WAS INITIALLY SELECTED AS THE NORMAL RETIREMENT

The Normal Retirement Age (NRA) under the Social Security program was established as 65 in the original Social Security Act (1935). The NRA, which is sometimes referred to as "the full-benefits retirement age," is the youngest age at which reduced benefits are first available. Some persons believe that age 65 was selected because Bismarck used this age at the initiation of the German national pension plan in the late 1880s, the first such program in the world. However, this was not the case, because such age was 70.

Instead, the NRA was set at age 65 in 1935 as a matter of compromise. The Townsend Plan, which would have provided $200 per month to all retired persons (and was really economically unsupportable), had an NRA of 60, and had strong public support. Some private pension plans had a NRA of 65, while others, generally in the railroad industry, had a NRA of 70. So, the "natural" compromise of the round figure of 65 seemed logical for the new Social Security program.

INCREASE IN NRA MADE BY 1983 AMENDMENTS

In 1982–83, the Social Security program had serious financing problems, both short-range and long-range. Among the benefit and financing changes made by the 1983 Amendments to solve these problems was a deferred, gradual increase in the NRA, which in fact was the final, balancing change. As a result, under present law, the NRA increases by 2 months for those who attain age 65 in 2003 and by an additional 2 months for each successive year-of-birth cohort until it reaches age 66 for those who attain that age in 2009. It then remains at age 66 until rising by 2 months for those attaining age 66 in 2021. Then, there are successive 2-month increases for each further year-of-birth cohort until it reaches age 67 for those who attain that age in 2027.

It may be noted that the plateau at age 66 for those attaining age 66 in 2009–20 resulted from the circumstance that the change in the NRA was supposed to produce exact estimated long-range actuarial balance for the total package of changes. If the NRA had "logically" moved up steadily beginning in 2003, by 2 months per year, until reaching age 67 in 2016, a small actuarial surplus would have been shown. Thus, the goal of a close estimated actuarial balance could only be achieved by deferring for a few years the increase in the NRA beyond age 66.

Much opposition was present with regard to even this small increase in the NRA, even though it was deferred and gradual. Many persons viewed retirement at age 65 (or even a few years earlier) as a basic right, regardless of work ability or employment availability. In my view, from the standpoint of the nation's well-being, the definition of "old-age" should not have been kept static over the years as longevity increased. By doing so, we have had a hidden continual liberalization of the program. Instead, we should have maintained the NRA at a level equivalent to what it was at the start. Specifically, the relationship between the retirement-life expectancy for a person aged 20 and the working-life expectancy of such a person should have remained about the same over the years.

Based on mortality rates in 1940, the retirement-life expectancy of a person aged 20 was 8.36 years for a NRA of 65, or 20.8 percent of the working-life expectancy of such a person (40.18 years). Using mortality rates of 1990, such a 20.8-percent relationship would be achieved with a NRA of 70.6 years. Thus, the increasing schedule of NRAs legislated by the 1983 Amendments was well below the NRAs equivalent to the relationship between the retirement-life expectancy and the working-life expectancy for a person aged 20 with a NRA of 65 at the inception of the program would have produced by 1990, let alone by 2027.

MY PROPOSAL FOR THE NRA IN THE FUTURE

I believe that the NRA should begin to increase for those who attain age 65 in 2003, as in present law, but when it reaches age 66, it should continue to increase by 2 months for each year-of-birth cohort indefinitely into the future, rather than remaining at that age for 12 years and then rising only to age 67. Thus, the NRA would become age 70 for those who attain that age in 2037 and age 75 for those who attain that age in 2072. At first glance, these rises might appear to be extreme, but it should be kept in mind that, with increasing longevity and accompanying work ability, the resulting NRAs will be well below the equivalent NRAs comparable to a NRA of 65 in 1940 certainly for many years to come and perhaps always so. In other words, if the NRA had originally been indexed to longevity, it would have been higher than would arise under my proposal to revise present law.

In the event that the proposed schedule of NRAs will, after many years, apparently exceed the NRAs equivalent to what age 65 was in 1940, this will be determinable well in advance. Appropriate action can then be taken to slow down or eliminate future scheduled increases, and this can easily be done both actuarially and politically.

As to the Early Retirement Age (age 62 in present law), I believe that it should remain at age 62 until the NRA reaches age 67, and then it too should rise, always being 5 years lower than the NRA. My proposal would have a significant effect on the estimated long-range financial status of the program. The long-range actuarial deficit of 2.2 percent of payroll according to the intermediate-cost estimate would be reduced by about two-thirds. The remaining deficit could easily be handled by such small and relatively non-controversial changes as covering all new state and local government employees, making the provisions for income-taxing benefits the same as are applicable to private pensions, and correcting the Consumer Price Index.

PROPOSALS TO INDEX THE NRA TO LONGEVITY

Proposals have been made to index, beginning in some future year, the NRA based on changes in retirement-life expectancy. In theory, this is an excellent approach, but it cannot be applied in a satisfactory manner. If the increase in the NRA is made shortly after the increase in life expectancy has been determined to have occurred as measured in some recent past year, the beneficiaries will not have had sufficient advance notice so that they can plan accordingly. On the other hand, if the indicated increase in the NRA is deferred and graded in for many years, the change will not have been sufficiently cost effective. Of course, it may be said that my proposal does involve indexing as a limiting factor that the Executive Branch and Congress would undoubtedly consider continuously over the years, so as to make ad hoc changes when indicated as being necessary.

CONCLUSIONS

The Social Security program has, according to the intermediate-cost estimate, a serious long-range financial problem. This has been due, to a considerable extent, to increased longevity—both in the past and very likely over the long-run future—coupled with maintaining a static NRA in the past and with only small increases therein scheduled for the future.

The demographic problem involved should be solved by demographic means—namely, a continuous small annual increase in the NRA in all future years. If this results, at some distant time, in the NRA becoming too high as measured by conditions then or relative to what age 65 was at the start of the program, it will be a relatively easy matter both actuarially and politically to slow down or cease the rises in the NRA. But it should be realized that the NRA should be on a dynamic basis so as to keep pace with increasing retirement-life expectancy, considering also work ability.

Chairman BUNNING. Go right ahead.

STATEMENT OF MERTON C. BERNSTEIN, COLES PROFESSOR OF LAW, EMERITUS, WASHINGTON UNIVERSITY, ST. LOUIS, MISSOURI; AND FORMER PRINCIPAL CONSULTANT TO THE 1983 NATIONAL COMMISSION ON SOCIAL SECURITY REFORM

Mr. BERNSTEIN. Thank you, Mr. Chairman. I want to congratulate this Subcommittee for launching these hearings. There's no domestic issue of greater importance to all generations than securing the future of Social Security. And I'm very much encouraged by what I've been hearing.

Certainly, there's been a tremendous amount of interest in normal retirement age. But the interest in it is exceeded only by the extent to which it is misunderstood. Most people seem to think that Social Security normal retirement age means the age at which most people retire. That is not the case. Most people retire before age 65, the current age.

Raising normal retirement age means simply cutting benefits—cutting benefits for everyone who retires after the effective date of the change. Now that is something that people don't understand. They don't understand that it cuts periodic benefits, no matter at what age they begin benefits. They don't understand that raising normal retirement age means cutting lifetime benefits for everyone who retires, who becomes eligible to retire after the effective date. This issue is primarily an issue with the baby boomers and their children. And they ought to understand what's involved, that it's their benefits that would be cut, and cut substantially, roughly 5 percent a year—5 percent for each year of raising the normal retirement age. We can't have an intelligent discussion of this issue until we know what it means.

I think it's a very radical thing to do. The long-term shortfall of Social Security is quite manageable without taking such radical steps.

Economists frequently talk about retirement age as if it is wholly or primarily a matter of choice. Well, for some people, happily, it is a matter of choice. But for tremendous numbers of people it is not a matter of choice. We have just gone through the wrenching years of downsizing, and they're not over. We have lost whole industries that were great employers.

For many people the reality frequently is that they're at work; they get an announcement that there will be downsizing of "X" number, "X" hundred or thousand of employees. That is coupled with what's called an early retirement incentive program. What's the early incentive program? It says retire early; you have one chance to elect to do so, and we'll carry you along until Social Security kicks in.

Those programs, which have been used again and again throughout American industry and business, put people to the test. They know that if they don't elect the early retirement option, they're likely to be laid off. So they take it. That's not a choice in my book.

Mr. Bunning, yesterday, you may have noticed the Philip Morris Co. announced just such a program for it plants in Richmond and Louisville. You've got several hundred people who are facing just that choice right now. Are they choosing to retire, if they elect to go out at age 57, 58, 59? I don't think so.

Further, rather than talking solely in terms of people choosing, we ought to be looking at the impediments to continued employment of older people. One is higher pay. Employers, personnel directors, managers know that frequently it costs more to continue to employ an older worker than a younger worker.

What happens? Well, frequently, that higher pay provides employers with an incentive which is, unfortunately, acted upon. Another major disincentive to the employment of older people is health care costs. Any health insurer will charge more for older people on the payroll than for younger people. Again, personnel managers don't have to be rocket scientists to know that when they do hiring. And although discrimination based on age in employment is illegal, the law is very hard—very hard—to enforce.

I do urge upon you to consider the very many other quite appropriate measures that can be taken to assure Social Security solvency without resorting to this quite radical step.

[The prepared statement and attachments follow:]

Statement of Merton C. Bernstein, Coles Professor of Law, Emeritus, Washington University, St. Louis, Missouri; and Former Principal Consultant to the 1983 National Commission on Social Security Reform

Some advocate raising Social Security's normal retirement age so as to trim program costs. Few proposals are as misunderstood. Many think it means that people will work longer. But, most studies show that increases, if any, would be measured in weeks or months, not years. In fact, raising the normal retirement age would:

(1) Reduce periodic benefits—throughout retirement—for the baby boomers

(2) Produce program savings by reducing benefits for all future retirees

(3) Increase Social Security Disability insurance outlays

(4) Provide little or no net program income gain; higher benefits for those working longer would offset additional payroll tax

(5) Cut benefits disproportionally for the low paid

(6) Bear most heavily on those already out of the work force: those who are ill, lack currently needed skills, worked in obsolete industries, are stranded by shutdowns

(7) Increase employer pension costs

(8) Work at cross purposes with private pension provisions and practices that permit and encourage earlier retirement

(9) Ignore disincentives to employing older workers—their higher pay and health insurance costs

Many working people do not have the choices some advocates of change assume. Backers of higher NRA seem to ignore that labor participation rates leveled off in the mid-1980s. The focus on changing Social Security ignores the probably more powerful effect of employer-sponsored plans.

1. Higher Normal Retirement Age Cuts Social Security Benefits For Baby Boomers

Raising normal retirement age means raising the age at which full benefits become payable. The effect is to reduce the periodic and life time benefits of all who retire thereafter. It is an issue that affects those still working

Lifetime benefits begun either before or after normal retirement age equal, on average, benefits begun at normal retirement age. With a higher normal retirement age, periodic benefits (the amount received each month), are reduced compared with those payable at a lower normal retirement age.

Currently, full benefits become payable to those who start benefit receipt at normal retirement age of 65. A person beginning benefits at age 62, the earliest age of eligibility for Social Security retirement benefits, receives 80% of a full benefit, with proportional reductions for those beginning benefit receipt in any month prior to age 65.

When normal retirement age becomes age 66 in the next decade, a full benefit becomes payable to those starting receipt at that age. Benefits begun at age 65 will be 95% of a full benefit. Those begun at age 62 will equal 75% of a full benefit. When normal retirement age becomes 67, the benefits begun at 62 become 70% of a full benefit. Under the 1983 amendments, the deferred retirement credit (an increase for delaying benefit receipt beyond normal retirement age) moves up slowly until, in 2009, it becomes the full actuarial equivalent of starting benefits at normal retirement age. From that date onward, retirements delayed past the normal retirement age would produce no savings for the program.

When normal retirement age gets raised, all benefits begun thereafter, no matter at what age, are 5% less for each year of increase. Those reductions continue throughout retirement.

2. Program "Savings" Come from Benefit Cuts

When normal retirement age goes up, benefit cuts are a certainty. Reported "savings" derive primarily from the described benefit reductions. Indeed, the "savings" to the program reported by the Social Security Administration's Office of the Actuary consist almost wholly of such benefit reductions. (See the attached 1984 memo from the Office of the Actuary projecting program savings from the 1983 amendments raising normal retirement age in the next century. No later comparable analysis exists because the Actuary assumes almost all of the program gain derives from benefit reductions.)

But many suppose that the system would obtain more revenue through people working longer and therefore paying more FICA (payroll tax). Whether any significant number would do so is speculative. Simulation studies project that additional work, if any, would be measured in weeks or months, not years. Whatever the sums so derived, they would produce little or no net gain to the Social Security program.

3. Higher Normal Retirement Age Boosts Disability Insurance Outlays

As the attached analysis by the Social Security Administration's Office of the Actuary shows, increased Social Security Disability Insurance (DI) benefit payments would cancel some of the "gain." DI benefits, which are not reduced because of the age at which they start, become regular retirement benefits when an individual on DI reaches that age. When that normal retirement age goes up, more of those already on DI will continue on those rolls and more possible eligibles will seek them.

4. Continued Work Does Not Improve Program Income; Additional Payroll Tax Yield Offset by Deferred Retirement Credit and Higher Benefits from Additional Earnings

Whether a significant number of people would feel impelled by the benefit cuts to continue at work is wholly speculative. But their numbers do not matter greatly because that additional work would not yield a significant net gain to the program. The deferred retirement credit confers an actuarial benefit increase for each month of delayed retirement. On average, lifetime benefits are the same, regardless of when people start to collect benefits; and higher credited earnings may increase the benefits due, thereby offsetting higher FICA payroll tax receipt.

Each month an individual works after the earliest age of benefit eligibility, now 62, improves his/her benefits by about 5% a year . The delay raises periodic benefits to their actuarial equivalent. That means that the program, on average, pays out an equal amount over the beneficiary's lifetime no matter at what age he/she starts receipt of benefits. In sum, no matter how long an individual delays the receipt of benefits, the program, on average, pays out the same amount over that individual's lifetime.

Further, that additional work may boost the average of lifetime earnings on which his/her benefit computation is based. Such increased credited pay would boost benefits, thereby canceling some portion of the additional FICA tax paid on the additional months of work.

These factors explain why the attached analysis by the Social Security Administration's Office of the Actuary attribute almost all of the savings from the 1983 amendments boosting normal retirement to benefit reductions.

5. Cuts Bear Disproportionally on the Lower Paid

One justification claimed for raising normal retirement age is that we are living longer, are healthier and can work longer. Further, it is claimed, the benefit reductions produced by raising the normal retirement age will be offset by longer periods of retirement and hence longer periods of benefit payment. On average, that's true.

But that analysis does not hold up for low-pay people, especially minority men, who tend to die earlier than the statistical average. The low paid have higher mortality rates and have the least chance of getting average lifetime benefits.

In any event, reductions in current benefits bear most heavily on low-income people because a proportionally larger part of their income goes for essential expenditures—for food, clothing, and shelter. Indeed, it is for that very reason that the Social Security benefit formula is weighted in favor of low-income earners.

From the program's point of view, total payout is not affected by how long people work. Whenever benefit payments begin, on average, they total the same over a lifetime. But, from the individual's point of view, it is the amount of *current benefits* that determine one's living standard. That is especially true for those most heavily dependent on their Social Security benefits—people who earned low or modest pay.

6. The Hardest Hit: The Lowest Paid, Those Already Out of the Work Force, Those Lacking Currently-Needed Skills; Those Who Worked in Obsolete Industries; Those Who Cannot Work Due to Illness or Family Circumstances

Program data show that almost all working people start Social Security benefit receipt before age 65, many at the earliest possible moment. Many such takers were out of work for six months or longer before beginning benefits. In reality, many such people are already out of the work force for good. Plant and other unit shutdowns, downsizing, former employment in obsolete industries, obsolete skills and illness account for many who begin benefit receipt at the earliest age of eligibility or soon thereafter because they are the least able to get work.

7. Raising Retirement Ages Will Boost Employer Pension Costs

Early retirement incentive programs that seek to induce employees to retire early typically offer bridging benefits until employees become eligible for Social Security benefits. Delaying that time by raising the age of earliest eligibility for retirement obviously will require employers to pay bridging benefits for a longer time. Reducing early retirement benefits by raising normal retirement age probably would have the same effect. When I testified in 1980 before Representative Ferraro on this subject, John Fibiger, representing the American Council of Life Insurance declared that employer costs would go up to offset the reduction in periodic benefits caused by boosting normal retirement age. (Hearings about Social Security retirement age before the U.S. House Committee on Aging (p. 81, 1980).)

8. Raising Normal Retirement Age Works at Cross Purposes with Private Pension Provisions and Practices That Permit and Encourage Early Retirement

For decades, private and state and local government pension plans have provided for retirement at much earlier ages than Social Security does. It is common for private plans to permit, even encourage, retirement—with full benefits—as early as age 62, 60, 58 and even 55. This indicates that employers find it desirable to facilitate employee retirement before Social Security provides full benefits or even reduced benefits.

Remember, too, that private pension plans receive tax favorable treatment. Why have we never heard proposals to withhold favorable tax treatment to plans with early retirement provisions?

Bear in mind also that private plans tend to be concentrated among the better-paid portion of the population. Professor Burkhauser's article and editorial ("Who Takes Early Social Security Benefits," 36 Gerontology, No. 6, pp. 789 and 726 (1996) found that more than 6 out of 10 who take Social Security early retirement also received employer pensions; 2 out of 3 early retirees (at age 62) lived in households receiving an employer pension. From this he argues that depriving them of Social Security prior to age 65 would not cause hardship.

Isn't it curious that those who propose radical changes in Social Security retirement age so as to discourage early retirement make no such proposal for employer-sponsored plans? Do we really want policies that facilitate early retirement for high-pay employees but cut benefits to all others so as to discourage their retirement?

9. Older Workers' Higher Pay and Health Insurance Costs Discourage Their Employment

Currently, employers pay higher health insurance premiums for older workers and frequently higher compensation as well. Despite the ban on discrimination in employment based on age, these factors give employers strong incentives to minimize the employment of older workers.

One reported mass separation illustrates how powerfully these disincentives operate to curtail the employment of older people. Despite some 3,000 unfilled teaching jobs in New York City, the Board of Education implemented its second "buy-out" (that is, early retirement incentive plan) so as to trim higher paid teachers from the payroll. It seemingly did not matter that this move aggravated an existing shortage of math and science teachers. (New York Times, July 29, 1996, page B1 (national edition).

Moreover, the law requires employers providing health insurance to offer those eligible for Medicare the choice of making the employer's plan primary and Medicare secondary. I have not seen any study of either employer or employee conduct in the light of that requirement enacted to reduce Medicare costs. But surely some employers, knowing of the possible employee election of the employer's plan, will find them more expensive, less attractive employees. And, as if that's not bad enough, the law also requires that dependents eligible for Medicare be given the same choice. You might wonder why employees and dependents would elect the employer's plan. The answer: many private plans cover prescription drugs and Medicare does not.

It seems both prudent and fair to remove health-care cost and Medicare election requirements, clearly impediments to continued employment, before trying to force people to work longer by cutting their Social Security benefits.

MANY DO NOT CHOOSE TO RETIRE; THEY ARE MADE TO RETIRE

Much of the discussion about retirement age assumes that almost all people *choose* to retire. That's a decidedly questionable assumption to make in the era of downsizing—which isn't over yet.

Just ask the people living in the cities and towns once populated by the aircraft, clothing, electronics, farm equipment, hat, photographic, shoe, steel, and textile industries, just ask the mayors of cities whose downtowns have died, whether employees chose to give up their jobs. For example, Missouri was the last bastion of the domestic shoe manufacturing industry. One by one the shoe plants, strung along Interstate 44 in small towns, shut down. Their former employees didn't have many choices, certainly not where they lived.

Read any story about downsizings and you will see that they feature early retirement incentive plans. When many large companies announce plans to trim hundreds or thousands of jobs, they offer older employees the choice of retiring early with a payment to bridge the time until Social Security kicks in. Employees know that if too few "choose" to retire, the necessary number will be fired. Such offers usually get accepted and often are oversubscribed.

It is no secret that older separated employees have a tough time finding employment, let alone obtaining jobs as good as the ones they lost. Two studies of major layoffs showed that about half of each group numbering in the hundreds of thousands got no job or ones inferior to the jobs they lost. Older employees especially suffered economic demotion.

Many economists talk about the factors that affect employee "choice" whether or not to retire. Those discussions and analyses make some daunting assumptions—that people know what their pension plans provide, how much in benefits they can expect under varying retirement age scenarios, and what Social Security provides at differing ages. And how many people know and understand Social Security's retirement test and can do the math to show the interaction of earnings and benefits as well as apply the differing formulas for those aged 62–64 and those 65 and older?

Most people start Social Security benefit receipt well before age 65—despite the fact that Medicare does not become available to them until age 65. That seems to argue that the inadequacy of benefits does not discourage retirement. And how many know that the courts allow employers to cancel their promise to pay for retiree health insurance?

I suggest, the rational choice picture drawn by economists is highly questionable—certainly for the mass of the population.

Some employed people may have sufficient knowledge about their pension plans and Social Security benefits to make a rational choice about what their income would be if they retired. Even if they do, can we expect that reducing periodic benefits by 5% or even 10% will shape their decision?

On top of that, to have a choice, older employees must have the prospect of continuing in a job or getting a new one. Often, that's the rub.

RAISING AGE OF EARLIEST ELIGIBILITY—A DISASTER FOR THE LOW PAID, LOW SKILLED AND ILL; PROGRAM SAVINGS, LITTLE OR NOTHING; ECONOMIC GAINS SPECULATIVE AT BEST

Some advocate not only raising the normal retirement age, but also raising the age of earliest eligibility—with quite questionable reasoning.

The employees who have no choice but to retire tend to be the people with ill health, obsolete skills, and those marooned in communities in which the major employer has disappeared. We know that people with low income are the people who rely most heavily on their Social Security benefits. Making them wait until age 65 could be disastrous.

What also makes this proposal questionable is the structure of Social Security benefits. If benefits begin at age 65, they will be larger than they would be at age 62—their total, on average, should be equal actuarially over the beneficiaries' lifetime. Put another way, changing the age of earliest retirement would not save Social Security any money on average, because the deferred retirement credit purposely makes average life-time benefits equal no matter at what age a person begins drawing benefits.

Professor Burkhauser reasons that more people at work will produce more goods and services, more for all of us to share. That surely is a worthy goal. We ought to pursue that enlarged pie by removing impediments to employment of older people, by providing fuller opportunities for education and training at all ages. But bludgeoning some people to work—primarily those without second pensions—seems a very distasteful way to go about creating a larger pie.

Moreover, labor participation rates leveled off in the mid-1980's. So, the proposal to rectify the trend to earlier retirement is a bit like the Maginot Line. It's designed for the last war.

Before making any radical changes in Social Security, we should turn our attention to the costs and benefits and roles of employer-provided pensions, especially when their coverage is shrinking, having fallen below half of the full-time work force.

LET'S KEEP AN EYE ON DEATH RATES AND LONGEVITY

A funny thing happened to the death rate in 1993—it went up. Concomitantly, life expectancy dropped for both males and females, both at birth and at age 65, not by very much, to be sure. (See attached Table II. D2 from the 1997 Annual Report of the OASDI Trustees, page 63). While the death rate dropped again in 1994, it was above the 1992 rate, with no longevity improvement at age 65 for women.

Missouri health officials speculated that the increased death rate might reflect the greater use of living wills. A later survey elsewhere noted that health care providers tend to ignore patient wishes on terminating life. Heightened interest in this subject could lead to more self-determination about when to end one's own life. Just where that movement will go, can hardly be foretold just now. But, it could lead to much more such decision making.

Were that to develop, earlier deaths would have only slight effect on Social Security outlays but probably a more substantial effect on Medicare expenditures. Moderating that program's costs would make meeting Social Security's obligations more manageable.

SUMMARY—RAISING SOCIAL SECURITY NORMAL RETIREMENT AGE AND EARLIEST AGE OF ELIGIBILITY MAKE QUESTIONABLE PUBLIC POLICY

Raising Social Security's normal retirement age has an initial plausibility. But, when the public discovers that raising normal retirement age would reduce benefits to all qualifying for retirement thereafter, that option becomes less attractive. The chilly public reception given to raising the age of eligibility for Medicare suggests that changing normal retirement age will be greeted skeptically, at best.

As we explore ways to assure Social Security solvency, as the media and public become better acquainted with the modest measures capable of achieving that desirable goal, more radical measures like changing normal retirement age will appear less urgent and that much more undesirable.

1. Based on the alternative II-B assumptions of the 1983 OASDI Trustees Report, the savings estimated from raising the normal retirement age, as a percentage of taxable payroll, are as follows:

Total Savings

Time period	OASI	DI	OASDI
1983-2007	-0.03	-0.01	-0.02
2008-2032	.85	-.15	.70
2033-2057	1.61	-.20	1.41
1983-2057	.83	-.12	.71

2. The composition of the savings estimate is as follows:

Time period	OASI	DI	OASDI
Savings Resulting From Reduced Benefits			
1983-2007	0.03	-0.01	0.02
2008-2032	.83	-.16	.68
2033-2057	1.58	-.20	1.38
1983-2057	.82	-.12	.69
Savings Resulting From Increased Income			
1983-2007	*	*	*
2008-2032	0.02	*	0.02
2033-2057	.03	*	.03
1983-2057	.02	*	.02

* negligible (less than 0.005 percent of taxable payroll).

3. The increase in the number of workers in covered employment resulting from the increase in normal retirement age is as follows:

Year	Change in Thousands	Year	Change in Thousands
2000	0	2030	740
2005	113	2035	697
2010	261	2040	671
2015	470	2045	682
2020	701	2050	705
2025	755	2055	717

Social Security Administration
Office of the Actuary
August 17, 1984

Table II.D2.—Selected Demographic Assumptions by Alternative, Calendar Years 1940-2075

Calendar year	Total fertility rate [1]	Age-sex-adjusted death rate [2] (per 100,000)	Life expectancy [3] At birth Male	At birth Female	At age 65 Male	At age 65 Female
Historical data:						
1940	2.23	1,672.6	61.4	65.7	11.9	13.4
1945	2.42	1,488.6	62.9	68.4	12.6	14.4
1950	3.03	1,339.9	65.6	71.1	12.8	15.1
1955	3.50	1,243.0	66.7	72.8	13.1	15.6
1960	3.61	1,237.9	66.7	73.2	12.9	15.9
1965	2.88	1,210.8	66.8	73.8	12.9	16.3
1970	2.43	1,138.4	67.1	74.9	13.1	17.1
1975	1.77	1,020.9	68.7	76.6	13.7	18.0
1976	1.74	1,010.1	69.1	76.8	13.7	18.1
1977	1.79	981.8	69.4	77.2	13.9	18.3
1978	1.76	976.3	69.6	77.2	13.9	18.3
1979	1.82	944.8	70.0	77.7	14.2	18.6
1980	1.85	961.1	69.9	77.5	14.0	18.4
1981	1.83	934.5	70.4	77.8	14.2	18.6
1982	1.83	906.4	70.8	78.2	14.5	18.8
1983	1.81	916.0	70.9	78.1	14.3	18.6
1984	1.80	909.2	71.1	78.2	14.4	18.7
1985	1.84	912.3	71.1	78.2	14.4	18.6
1986	1.84	904.8	71.1	78.3	14.5	18.7
1987	1.87	895.6	71.3	78.4	14.6	18.7
1988	1.93	906.0	71.2	78.3	14.6	18.7
1989	2.01	882.4	71.5	78.6	14.8	18.9
1990	2.07	865.9	71.8	78.9	15.0	19.0
1991	2.07	854.8	71.9	79.0	15.1	19.1
1992	2.06	843.6	72.2	79.2	15.2	19.2
1993	2.04	863.4	72.0	78.9	15.1	19.0
1994	2.04	852.2	72.2	79.0	15.3	19.0
1995 [4]	2.02	838.4	72.6	79.0	15.6	19.0
1996 [4]	2.01	832.0	72.6	79.3	15.5	19.2

Chairman BUNNING. Thank you, sir.

Dr. Richard Burkhauser.

STATEMENT OF RICHARD V. BURKHAUSER, SYRACUSE UNIVERSITY, CENTER FOR POLICY RESEARCH, SYRACUSE, NEW YORK

Mr. BURKHAUSER. Thank you, Chairman Bunning.

I'd like to agree with Mr. Neal that our Social Security system was the best system the government could have devised to protect older persons in the thirties. It met the needs of a country in which average life expectancy was about age 60, and little of value to society was expected from those lucky enough to reach age 65 and beyond.

Furthermore, the Great Depression had shaken the belief that our economy could grow enough jobs for those who wanted to work. Under the circumstances, setting a retirement age at 65 and penalizing those who worked beyond that age through lost benefits made some policy sense. Two major changes have occurred in our society since the thirties that make it painfully obvious that the norms of that long ago period do not describe our country as we approach the 21st century.

The first is life expectancy. Life expectancy is now approaching age 80. And even more important, most Americans can expect to be free of severe work impairments well into their seventies. We are a much healthier society, measured either by morbidity or mortality, and society has much to gain by encouraging older persons to continue to work.

Second, our economy has proven to be the job creation marvel of the world. Those who argued that the great transformation, for instance, of women into the work force would displace men have been grossly proven wrong. Today, unemployment rates are lower than they have been since the sixties.

The issues for the 21st century will revolve more around how to retain highly skilled and healthy members of the aging baby boom generation, of which, by the way, I'm the oldest member, than figuring out how to force older people out of the labor force, which was much of what the early Social Security retirement benefit program was about.

The good news is that policy changes already made in the 1983 amendments to the Social Security Act are working. The trend toward earlier and earlier retirement is over. If you look at Tables 2 and figures 1 and 4 in my formal statement, you'll see that the labor force participation rates of men aged 60 and 64 and 65 to 69 between 1985 and 1996 are far above what straightline projections, based on the previous 25 years of experience, would have predicted. The same is true for older women.

Raising both early and normal retirement ages will even further increase work at these ages, and as our healthy lifespans increase, it makes sense to do so, both from a social and a financial perspective.

Now will there be hardships? Yes. This will cause hardships for some. However, we have great data—the Health and Retirement Study which the Congress has financed since 1990 through its appropriations to the National Institute on Aging. This study follows the latest group of people moving toward early retirement age, so we can actually see what the characteristics of people who are taking early Social Security benefits are.

In tables 3 and 4 of my formal statement, I look at the current cohort of men and women who first took Social Security benefits at age 62 in 1992–94, and compare them with those who postponed benefits. The big story is, on average, early takers are as healthy and as wealthy as postponers. The stereotype of an early taker, unable to work and lacking private pension protection, does not fit most early takers. On average, men who take early Social Security benefits at age 62 appear to be nearly as well off financially and as healthy as men who postpone acceptance. Overall, women who take early Social Security benefits at age 62 are better off financially, but less healthy than women postponers.

If you look at the typical male early Social Security taker, black or white, that person is also eligible to receive employer pensions. Among white males, 66 percent of early takers have employer pensions. Among black males, 61 percent have employer pensions.

The typical male taker, black or white, has no health condition that affects his ability to work. Few male takers, black or white, fit the stereotype of being both in poor health and dependent on Social Security as their only source of pension income. I estimate about 7 percent of white males and 11 percent of black males fit this stereotype.

These results from the Health and Retirement Study suggest that the majority of men who take early Social Security benefits at age 62 are also eligible to receive an employer pension, are in good health, and have assets similar to those who postpone Social Security benefits. It's the rare male taker who is both in poor health and dependent on Social Security.

Most older workers who retire early do so because they are financially able to. For such workers, raising the early retirement age will not cause major hardships and will increase overall productivity.

The 1935 Rolls Royce was undoubtedly the greatest car made up to that time, but no one would argue that the 1935 Rolls Royce is the car that we ought to be driving around in today. There have been changes in society and changes in technology that make this obvious. When I argue for changes in the Social Security system I am not arguing that the system has failed; rather, I am arguing that our society has changed and the Social Security system should change with it.

Thank you.

[The prepared statement follows. Additional materials are being retained in the Committee files.]

Statement of Richard V. Burkhauser, Syracuse University, Center for Policy Research, Syracuse, New York

The Report of the 1994–1996 Advisory Council on Social Security (1997) finds a deterioration in the long range financial condition of Social Security and urges that concentrated action be taken promptly to reverse this trend. Raising both the normal retirement age and the earliest age of retirement is one method of accomplishing this result.

In contemplating such increases in the retirement ages for Social Security, two issues arise: (1) would a larger number of people stay in the work force past age 62? (2) would this cause serious and widespread economic hardship to a large number of people who would still not work past age 62? Preliminary evidence suggests the answers are yes and no respectively. Thus, I favor raising the retirement age as one method of adjusting Social Security policy to the improved health and life expectancy of the baby boom generation.

I. WOULD RAISING THE EARLIEST RETIREMENT AGE TO 65 INCREASE WORK? [1]

Table 1 shows the labor force participation rate of older males from 1940 through 1996. There is now general agreement that disincentives to work at older ages contained in both Social Security and employer pension plans played an important role in the dramatic drop in retirement age from 1950 through 1985 as shown in this Table. (See Quinn and Burkhauser 1994 for a review of the literature.) Nonetheless, skepticism exists over the ability of policy changes to both stop this trend and increase work at older ages. In my view, not only is it possible for social policy to encourage workers to stay in the work force longer, but changes in public policy already set in motion by the 1983 Amendment to the Social Security Act, together with a strong economy, have already ended the trend toward early retirement. Figures 1 through 4 in Burkhauser and Quinn (1997) show how profoundly the trends in labor force participation rates have changed for older men and women since 1985. The figures show the labor force participation rates of older men (aged 60 to 64, aged 65 to 69) and older women (aged 55 to 59, aged 60 to 64) from 1964 through 1996, and use a linear time trend based on the 1964 to 1985 data to project labor force participation rates from 1986 through 1996. In all cases, projected rates are far below actual rates. Table 2 from Burkhauser and Quinn (1997) plots these differences and finds that over two million more older men and women in these age ranges are in the labor force than would have been predicted based on past trends. While it is difficult to disentangle the relative importance of specific policy changes from macroeconomic factors and changes in personal characteristics that occurred

[1] The discussion in this section of my talk is based on Burkhauser and Quinn (1997).

Table 1. Male Labor Force Participation Rates by Age in the United States, 1940 to 1996

	Age												
Year	55	60	61	62	63	64	65	66	67	68	69	70	72
1940[a]	93.8	85.5	83.6	80.0	80.4	77.0	70.0	68.1	60.3	58.5	56.3	48.6	---
1950[a]	90.6	84.7	82.3	81.2	79.8	76.8	71.7	67.1	59.4	57.7	54.5	49.8	39.3
1960[a]	92.8	85.9	81.6	79.8	77.8	71.5	56.8	49.0	42.7	42.0	39.0	37.2	28.0
1970	91.8	83.9	80.1	73.8	69.4	64.4	49.9	44.7	39.4	37.7	34.0	30.1	24.8
1975	87.6	76.9	73.5	64.4	58.3	54.2	39.4	34.2	30.5	23.7	25.8	23.7	22.6
1980	84.9	74.0	69.6	56.8	52.3	48.8	35.2	30.4	27.9	24.1	23.0	21.3	17.0
1985	83.7	71.0	66.5	50.9	44.7	42.2	30.5	26.5	23.7	20.5	19.5	15.9	14.9
1990	85.3	70.5	67.0	52.5	45.5	40.9	31.9	27.2	27.0	23.4	19.0	17.1	16.4
1995	81.1	68.9	62.0	51.3	43.2	40.3	33.5	30.2	25.8	22.4	21.9	20.6	16.0
1996	81.9	67.5	64.8	51.5	45.3	40.6	33.4	31.7	26.5	22.7	22.2	21.3	16.3

[a]Based on adjusted U.S. Bureau of the Census labor force participation data. The adjustment is based on the ratio of CPS figures and census figures in 1970.

Source: Labor force participation figures from 1970 to 1996 are based on unpublished data from the *Current Population Survey* (CPS).

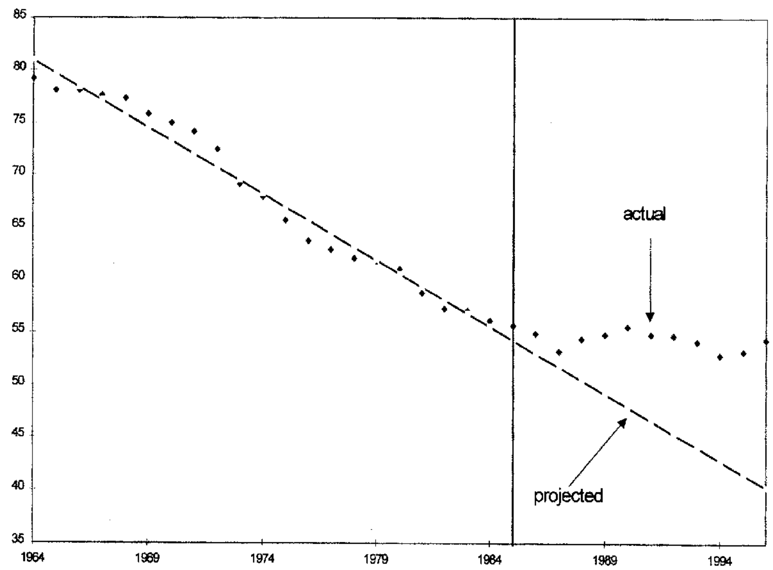

Figure 1 Labor Force Participation Rates of Men Aged 60-64 in 1964-1996.
Source: Quinn 1997.

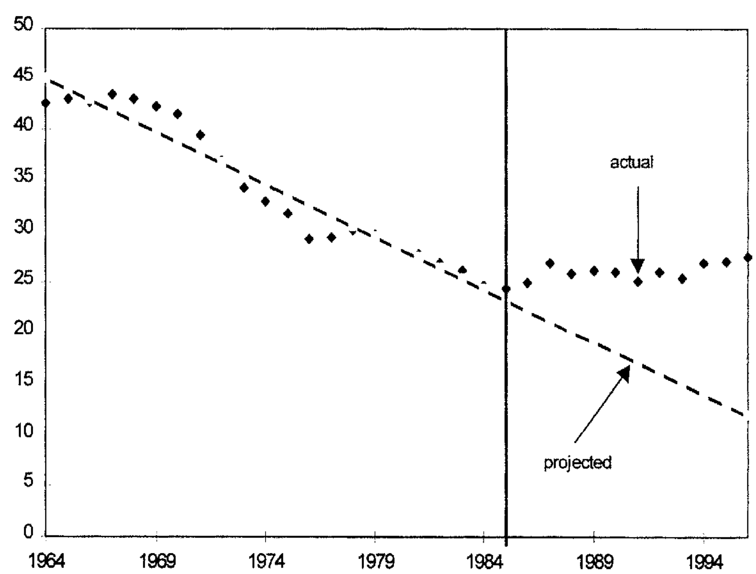

Figure 2 Labor Force Participation Rates of Men Aged 65-69 in 1964-1996.
Source: Quinn 1997.

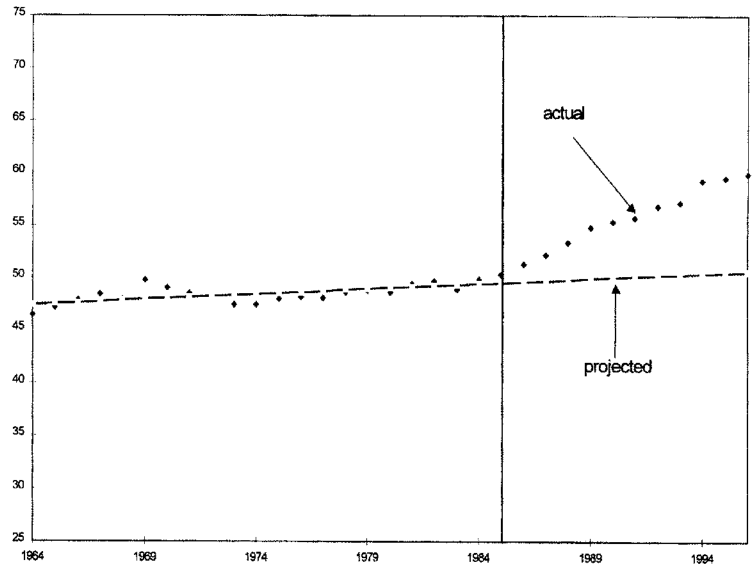

Figure 3 Labor Force Participation Rates of Women Aged 55-59 in 1964-1996.
Source: Quinn 1997.

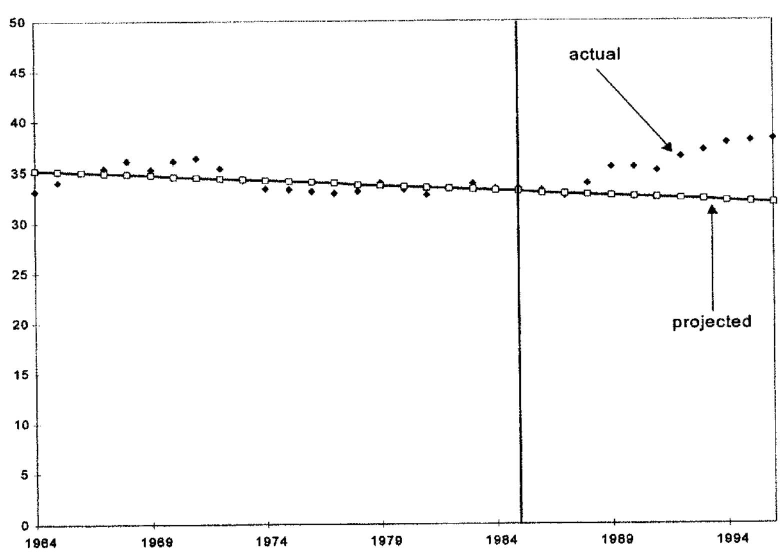

Figure 4 Labor Force Participation Rates of Women Aged 60-64 in 1964-1996.
Source: Quinn 1997.

over the period, it is possible to say from Table 2 that the long post-World War II trend toward early retirement is over.

Removing disincentives to work or constructing incentives to work would have no impact on the labor force participation of older persons if they had no desire to work longer. But this is not the case, as McNaught, Barth, and Henderson (1989) report using Harris poll information. This survey evidence suggests that many older Americans would like to work more than they do. Quinn and Burkhauser (1994) analyzed the subsample of this survey who were still employed and found that a substantial minority—over one million—expected to stop work before they wanted to. Many more older workers preferred part-time work than had it. These are the "unexpected" older men and women workers captured in Table 2.

Returning the Social Security earliest retirement age to its 1960 level of age 65 as the normal retirement age is increased to 67 or higher over the next two decades would send an important market signal to employees and employers that additional work at older ages is expected. In my view such a change in Social Security policy would have a substantial impact on employment at those ages. But additional research is necessary to more accurately determine the size of this change. Fortunately a major new data set—the Health and Retirement Study—will allow researchers to make such estimates.

II. Would Raising the Earliest Retirement Age to 65 Cause Widespread Economic Hardship [2]

Raising both the normal and earliest age of eligibility for Social Security benefits would increase employment among older people and delay acceptance of Social Security benefits.[3] This would both reduce the future liabilities of the Social Security system and increase general economic production. But these advantages of returning the first age of eligibility for benefits to 65 must be weighed against the negative impact on economic security it would cause at ages 62 through 64, especially for those who are limited in their ability to work because of health or who have no employer pension plan to cushion their transition out of the labor force and into retirement.

Table 2. Actual and Projected Labor Force Participation Rates and Number of Workers, in Thousands, by Age and Sex Categories: 1996

	Labor Force Participation (percentages)			Workers (thousands)		
Age Group	Projected	Actual	Difference	Projected	Actual	Difference
Men						
60 to 64	40.3	54.3	14.0	1,897	2,558	661
65 to 69	11.8	27.5	15.7	532	1,239	707
Women						
55 to 59	50.6	59.8	9.2	2,674	3,162	488
60 to 64	31.9	38.2	6.3	1,719	2,057	338
Total						2,194

Source: Population figures are based on U.S. Bureau of the Census, release PPL-57 estimation for July 1, 1996. Labor force particiaption rates come from *Employment and Earnings*, January 1997. Employee Benefit Research Institute. 1997. *EBRI Databook on Employee Benefits*, 4th edition. Washington, DC: EBRI.

Policymakers considering an increase in the minimum age for early Social Security benefits need to know how workers currently transition into retirement and to understand the circumstances surrounding this important life event. If early beneficiaries were in good health and could work, or could rely on employer pension income to support their decision to retire earlier than age 65, then such a change, while painful, would be unlikely to have serious economic consequences. However, for early beneficiaries who are limited in their ability to work because of health or

[2] The discussion in this section of my talk is based on Burkhauser and Phillips (1997).

[3] Under current Social Security rules, the normal retirement age will gradually increase to age 67 over the first part of the 21st century, but the earliest age of benefit eligibility will remain age 62. Burkhauser and Quinn (1994) review the economic literature and conclude that, unless major changes take place in employer pensions, these changes alone will have only a minor effect on employment.

are not eligible for employer pensions, raising the early Social Security retirement age to 65 could cause serious hardship.

Evidence from the Health and Retirement Study (HRS)

The HRS is currently following a cohort of men and women who were aged 51 to 61 in 1992 when they were first surveyed. The second wave of data, which contains information on these same people in 1994, provides a first look at the characteristics of early Social Security retirees. Using data from the HRS, Table 3 looks at men and women who turned age 62 between wave 1 and wave 2 and compares the employer pension eligibility, net assets, health, and household pension receipt of those who took Social Security benefits at age 62 (takers) to those who did not (postponers). This is done for the entire population and by race and gender groups. (This table is an extension of work first developed in Burkhauser, Couch, and Phillips 1996.)

KEY POINTS OF TABLE 3

- On average, men who take early Social Security benefits at age 62 appear to be as well off financially and as healthy as men who postpone acceptance.
- Overall, women who take early Social Security benefits at age 62 are better off financially but less healthy than women postponers.
- There are clear differences between racial groups. Black men this age have substantially less wealth and poorer health than white men. Black male takers are wealthier but in poorer health than black male postponers. Black women have substantially less wealth than white women. Black women takers are wealthier and healthier than black women postponers.

Table 4 separates takers and postponers based on employer pension and health status within race and gender groups.

KEY POINTS OF TABLE 4

- The typical male early Social Security taker (black or white) also is eligible to receive an employer pension—white males 66 percent, black males 61 percent.
- The typical male taker (black or white) has no health condition that affects his ability to work—white males (79 percent), black males (72 percent).
- Few male takers (black or white) are both in poor health and dependent on Social Security as their only source of pension income—white males (7 percent), black males (11 percent).
- Women takers (black or white) are less likely to have an employer pension than male takers and more likely to be in poor health.

These results from the HRS suggest that the majority of men who take early Social Security benefits at age 62 are also eligible to receive an employer pension, are in good health, and have net assets similar to those who postpone Social Security acceptance. It is the rare male taker who is both in poor health and dependent on Social Security benefits as his sole source of pension income—7 percent for white males, with only a slight increase to 11 percent for black males.

These results do not suggest that raising the earliest retirement age would be painless or that some workers would not suffer major losses in economic well-being. But it does suggest that in 1994, the typical male worker taking Social Security benefits at age 62 was physically able to continue working or was eligible to receive an employer pension benefit and thus unlikely to be devastated financially by legislation raising the earliest age of eligibility for Social Security retirement benefits.

Table 3. Summary of the Characteristics of All Men and Women First Eligible to Receive Social Security Retirement or Spousal Benefits at Age 62 in 1993 or 1994 by Benefit Status and Race[a]

	Takers						Postponers					
			Median Household Net Assets[c]						Median Household Net Assets[c]			
Race	Share Taking Benefits at Age 62	Pension Eligible 1992[b]	1992	1994	Poor Health 1994[d]	Household Pension 1994[e]	Share Postponing Benefits at Age 62	Pension Eligible 1992[b]	1992	1994	Poor Health 1994[d]	Household Pension 1994[e]
Black												
Men	0.29	0.61 (0.50)	$79,750	$83,500	0.39 (0.50)	0.58 (0.50)	0.71	0.57 (0.50)	$54,800	$55,000	0.26 (0.44)	0.20 (0.40)
Women	0.28	0.40 (0.50)	$56,850	$60,000	0.27 (0.45)	0.36 (0.49)	0.72	0.25 (0.44)	$35,900	$45,000	0.38 (0.49)	0.29 (0.45)
White												
Men	0.27	0.66 (0.48)	$185,100	$181,000	0.22 (0.42)	0.72 (0.45)	0.73	0.63 (0.48)	$182,500	$208,550	0.20 (0.40)	0.32 (0.47)
Women	0.32	0.25 (0.44)	$182,000	$187,000	0.30 (0.46)	0.61 (0.49)	0.68	0.46 (0.50)	$162,750	$186,500	0.24 (0.43)	0.41 (0.49)
All												
Men	0.27	0.65 (0.48)	$155,500	$160,200	0.22 (0.41)	0.71 (0.45)	0.78	0.60 (0.49)	$143,000	$150,000	0.21 (0.41)	0.30 (0.46)
Women	0.30	0.26 (0.44)	$147,300	$151,000	0.31 (0.46)	0.57 (0.50)	0.70	0.39 (0.49)	$109,000	$114,500	0.26 (0.44)	0.39 (0.49)

[a]Standard deviations for mean values are in parentheses.
[b]Respondent reports either receiving private pension income in 1992 or that he or she expects to receive private pension income in the future.
[c]Includes all household assets minus debts. Does not include pension wealth.
[d]Respondent reports being in fair or poor health in 1994.
[e]Respondent or spouse reports receiving income from employer pension in 1994.
Source: Health and Retirement Study, Gamma version of Wave 1 (1992) and Beta version of Wave 2 (1994). For more details see Phillips (1997).

Table 4. Employer Pension Eligibility, Health, and Household Net Assets of Men and Women Who Take or Postpone Taking Social Security Benefits at Age 62 in 1993 or 1994

				Takers			Postponers		
		Employer Pension	Poor Health	Sample Share	Median Household Net Assets		Sample Share	Median Household Net Assets	
Race	Gender	Eligibility[a]	1994[b]	[obs]	1992	1994	[obs]	1992	1994
Black	Men	yes	yes	0.18*	---	---	0.07*	---	---
		yes	no	0.43	$90,000	$102,500	0.41	$83,250	$78,000
		no	yes	0.11*	---	---	0.21	$2,500	$105
		no	no	0.29*	---	---	0.31	$32,900	$48,000
White	Men	yes	yes	0.15	$193,000	$103,750	0.11	$123,000	$105,000
		yes	no	0.51	$180,550	$202,700	0.50	$180,250	$218,465
		no	yes	0.07*	---	---	0.09	$144,350	$161,000
		no	no	0.28	$207,480	$218,500	0.29	$203,000	$194,500
Black	Women	yes	yes	0.03*	---	---	0.07*	---	---
		yes	no	0.35	$82,750	$126,750	0.19	$85,500	$126,000
		no	yes	0.27	$7,200	$33,000	0.29	$3,100	$5,750
		no	no	0.35	$56,000	$46,900	0.45	$36,750	$44,750
White	Women	yes	yes	0.03*	---	---	0.07	$140,100	$216,300
		yes	no	0.20	$153,000	$198,000	0.36	$190,000	$225,000
		no	yes	0.26	$199,250	$154,500	0.16	$92,468	$77,500
		no	no	0.51	$187,000	$191,500	0.40	$166,150	$192,750

[a]Respondent reports either receiving private pension income in 1992 or that he or she expect to receive private pension income in the future.

[b]Respondent reports being in fair or poor health in 1994.

*Less than ten observations. Medians are not reported in these cases.

Source: Health and Retirement Study, Gamma version of Wave 1 (1992) and Beta version of Wave 2 (1994). For more details see Phillips (1997).

FUTURE RESEARCH

These early results from the HRS only begin to reveal the health and economic characteristics of today's older workers as they make the transition between work and retirement. As additional waves of data become available and are linked to previous data waves, as well as to Social Security records, researchers will be able to more fully explore the transition into early retirement from a multi-period perspective. This will allow researchers to see better how the economic well-being of this cohort changes and to measure the degree to which our retirement system protects older people from dramatic drops in economic well-being, or even from a fall into poverty.

More importantly, these results begin to identify the critical variables that influence the work to retirement transition. While these results suggest that the majority of workers who retire early do not have work-limiting health conditions and are not significantly worse off financially or from a health perspective from those who postpone early Social Security acceptance, more sophisticated analysis is necessary to estimate the importance of health, employment conditions, and government policy on the retirement decision of older workers.

Disentangling the importance of policy variables from changes in health is the critical unresolved behavioral question with respect to the retirement decision. Aggregate data in Table 1 and in the figures show that the trend toward earlier retirement that characterized the American labor market from the end of World War II through 1985 has ended. The labor force participation rates of both older men and women are higher than straight line trends predict. Some of this increase is the result of policy changes which have reduced the anti-work aspects of Social Security. The HRS data will enable researchers to more fully unravel the factors behind the retirement decision by looking at how public policy variables, such as Social Security and employer pension benefit levels, and changes in these levels based on additional work years, interact with health and general economic conditions, which are less affected by public policy, on the retirement decision.

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Chairman BUNNING. You got that all in in less than 5 minutes. Congratulations.

I messed up your name the first time. So I'm going to call you "Mr. G."

STATEMENT OF RON GEBHARDTSBAUER, SENIOR PENSION FELLOW, AMERICAN ACADEMY OF ACTUARIES

Mr. GEBHARDTSBAUER. That's what my Dad was called.

Good afternoon, Mr. Chairman, Members of the Subcommittee. My name is Ron Gebhardtsbauer, and I'm the senior pension fellow with the American Academy of Actuaries. The Academy is the nonpartisan organization for actuaries in the United States, and as such, we don't endorse legislation. Rather, we analyze it for its advantages and disadvantages.

We're here today to talk about raising the normal retirement age because we're living a lot longer, and it seems like the logical solution to solving Social Security's financial problems. But it has many complex interactions, as you mentioned, Mr. Chairman, with other programs and difficult effects on various subgroups.

As my written testimony shows, I can get into a lot of those issues, but I'd like to save time to avoid the red light and move on, focusing on, what are some of the options that we can use in order to make some of these ideas of raising the retirement age more workable. For instance, using Social Security to enable people to phase into retirement and go into part-time employment, and get a part-time Social Security benefit.

But before I get into that, let me first talk about some of the concerns. First of all, it was mentioned earlier that raising the Social Security normal retirement age decreases everybody's benefits, but one advantage of increasing the normal retirement age is it doesn't decrease everybody's benefit; it doesn't decrease the benefits for disabled people. They will still get 100 percent of their benefit.

One other concern is that, by increasing the normal retirement age, benefits at age 62 become smaller and smaller, and could become inadequate for some people with low incomes. There are some options here that maybe you might want to consider, and of course one of them is to not give a benefit age 62 anymore, to increase the age at which you can get your benefit at the earliest age. Another idea, another option, is to maybe guarantee a benefit equal to the poverty level, a minimum benefit of that amount.

Of course, these options not only have advantages, they also have disadvantages. For example, not having benefits at 62 anymore would be a special difficulty for people who have more strenuous jobs, who often retire early, or people who are partially disabled and can't get a disability benefit because they're not disabled enough. For those people, they won't be able to get a Social Security benefit, and they may have a hard time finding a job.

Also, there's concerns for people who are minorities and people with low incomes who don't live as long, but as we discussed a little bit earlier, Social Security is not a regressive system. The tilt in the benefit formula (and the survivor and disability benefits) make it progressive, even for minorities who don't live as long.

Another thing we need to think about before we raise the retirement age are these two questions: Can we work past 67? And as discussed already, not only are we living longer, but we're also healthier at older ages, and in fact these studies indicate that someone age 70 now is more healthy than someone age 65 back around when Social Security was created.

Another question is, will employers keep us beyond age 67? And the evidence is there that employers are less likely to hire older employees, and one of the reasons is because older workers, as mentioned earlier, do cost more. Their health insurance, for instance, is more expensive. (However, their pension and post-retirement health costs can be lowered, when they work longer.)

So let's talk about the effects on employers of raising the normal retirement age. While increasing the normal retirement age will keep the employer's FICA taxes down, it may shift the cost of retirement to the employers instead. They may end up with older work forces, and their benefit costs will go up. If the employers decide that they want to encourage the employees to retire at a younger age, they could do it by increasing their pension benefits, but then that will also cost a lot.

We want employers to buy into this idea, too. Maybe we have an option here. How can we get employers and employees to buy into this? Well, I've got a chart over here on my left that I'd like you to look at, and it illustrates something that would be helpful. If you look at this chart, it shows the average annual increases in the labor force, and back in the sixties and the seventies, because of all the women coming into the work force and the baby boomers, increases in the labor force were big. It's now plummeting, though, and in fact when you reach the year 2008, the increase in the work force will be less than the increases in the population—for the first time in 50 years, since 1960.

So that may change our thinking. Employers may want to rethink their retirement strategies. Instead of pushing employees out when they reach a certain age, they may want to encourage employees to stay.

Well, there are ways in which Congress can help on this. If Congress, for instance, lets people choose when they want to retire and how to phase in their retirement, instead of having Social Security determine when you retire by using this earnings test, as we discussed earlier, then there's more choice involved, but also it gives employers the chance to continue employing their workers, maybe at a part-time level, but also not have as high payroll costs, due to the payment of a partial Social Security benefit. This could encourage employees to work longer (although part time), rather than the earnings test which discourages work.

Also, it's already being done. The Federal Employee Retirement System already pays part-time benefits to part-time retirees that have already retired. And you may want to give this option to employers to allow them to phase-in retirement for their employees by giving them part of their pension at an age.

This has some advantages, as I mentioned before, but it also has a disadvantage that was mentioned earlier. If you eliminate the earnings test, you end up having cash problems now, but in the long run it does not lose Social Security money. So that's another option that we might want to think about.

And I see my red light came on, so I'd better stop here.

[The prepared statement and attachments follow:]

Statement of Ron Gebhardtsbauer, Senior Pension Fellow, American Academy of Actuaries

The American Academy of Actuaries is the public policy organization for actuaries of all specialties within the United States. In addition to setting qualification standards and standards of actuarial practice, a major purpose of the Academy is to act as the public information organization for the profession. The Academy is nonpartisan and assists the public policy process through the presentation of clear, objective analysis. The Academy regularly prepares testimony for Congress, provides information to federal elected officials and congressional staff, comments on proposed federal regulations, and works closely with state officials on issues related to insurance.

Chairman Bunning, committee members, staff, and fellow panelists, Good Afternoon. My name is Ron Gebhardtsbauer and I am the Senior Pension Fellow at the American Academy of Actuaries. The Academy is the nonpartisan public policy organization for actuaries in the United States and does not endorse or propose legislation. Instead, we analyze the potential effects of legislation and evaluate its advantages and disadvantages relative to current law.

In the interest of time, I have provided the subcommittee with copies of my full testimony on this subject, so that I can focus on the most important points at this hearing, namely:

(1) What effects would an increase in the Normal Retirement Age have on individuals, employers, and the Social Security system?

(2) If Congress decides to increase the Normal Retirement Age, what should it be?

EFFECTS OF AN INCREASE IN THE NORMAL RETIREMENT AGE (NRA)

Many proposals to solve Social Security's financial problems have suggested that the retirement age should be increased, because our life expectancies are much higher today than they were when Social Security was created. Currently, the Normal Retirement Age, or age for full retirement benefits, is 65, the same as it was at the beginning of Social Security. It starts to gradually increase to age 67 in just 2 years (the year 2000) at which point the Normal Retirement Age will become 65 and 2 months for people born in 1938. If these people still retire at age 65, their retirement benefits will be about 1% lower [1] than if the Normal Retirement Age had remained at 65. If the NRA had increased to age 66 all in one year, benefits would have dropped immediately by about 7%. This large decrease would be similar to the notch baby benefit decreases which caused much alarm among the elderly in the 1980's. Phasing in the increase in retirement age over 6 years from 2000 to 2005 avoids this problem. Eventually the NRA reaches age 67 in 2022 for people born in 1960 and later. (A chart in my attachments provides these changes in detail, along with the retirement ages proposed by the Advisory Council.)

EFFECTS ON INDIVIDUALS

Thus, any proposal to gradually increase the normal retirement age by 1 year is similar to a proposal to gradually decrease the benefit formula by about 7% for people who still desire to retire at the same age.[2] Because we are living longer (on average), some contend that this is not a decrease in benefits at all—it is keeping total lifetime benefits the same. These people argue that keeping the retirement age frozen at 65 is actually a benefit increase, because benefits are gradually being paid for more years. However, if you look at it from the point of view of money's worth calculations, you will see that the return for future beneficiaries will not be as good as the returns received by current beneficiaries (but that is also because of other factors).

Disabled beneficiaries will not be hurt. Raising the NRA will not seem like a good idea for someone who cannot work any longer. If they qualify for a disability benefit, however, there is good news. Disability benefits will not be reduced by an increase in the retirement age. Disabled individuals will still get 100% of their full benefit (or Primary Insurance Amount), no matter how young they are at disablement (and they will get the benefit as long as they are disabled). This will encourage more people around age 65 to file for disability benefits (thus offsetting some of the savings

[1] Since people born in 1938 get their wages indexed one more year than people born in 1937 (and one less COLA), there is little likelihood that a notch will occur (assuming the wage index for 1997 wages will be more than the COLA in 1999). Even a 4 year phase-in would probably not create a noticeable notch.

[2] Increasing the retirement age by 3 years from 67 to 70 would be similar to a proposal decreasing retirement benefits by about 21%.

of the higher NRA), and the actuaries at Social Security have taken this into account in their cost projections for the current system and the various proposals.

Current beneficiaries and some future dependents and survivors won't be hurt. Other people who will not be affected by an increase in the retirement age are current beneficiaries (due to the prospective phase-in), survivors that are age 60 or younger on entitlement [3], children, and parents (or grandparents) caring for eligible children. Of course, this means that increasing the retirement age doesn't save quite as much as an across the board 7% decrease in benefits, but that is intentional, and not a surprise. [4]

Inadequate Benefits: A concern with raising the Normal Retirement Age is that it could create inadequate benefits at age 62. For example, if the normal retirement age becomes 70, then the age 62 benefit will be only 55% of the age 70 benefit. Some people who opted for the age 62 benefit might use up their savings quickly and need public assistance (thus costing the government more elsewhere). This could be happening at the same time that employers are reducing their post-retirement medical plans, and government may have to cut back on Medicare and Medicaid. Thus, retirees would need more income, not less. The Gramlich Individual Account proposal addressed this concern by decreasing benefits by 7% but only for benefits above the first bendpoint. Proposals to raise the NRA can also resolve this through minimum benefits, or by increasing the earliest retirement age (i.e., the Earliest Eligibility Age), or people could work longer.

Minimum Benefits: A minimum benefit equal to the poverty level (or some percent of poverty) might resolve this concern about inadequate benefits. However, it would have to be implemented carefully, since there are numerous concerns, such as:

(1) Cost,

(2) Who is eligible for it? (i.e., should someone who worked only 10 years under Social Security get the minimum benefit?)

(3) Would it be phased in (i.e., Should someone who worked 15 years get as much as someone with 40?)

(4) Once someone qualifies for a year of work or becomes eligible for it, there is no more incentive to report income or pay the tax.

(5) Would it be reduced for early retirement?

(6) Would disabled beneficiaries get it? Receipt might discourage rehabilitation and going back to work.

Increase the Earliest Retirement Age: Another solution for inadequate benefits at age 62 is to increase the earliest retirement age when increasing the normal retirement age. This would be a revenue raiser, and it would solve 10% of Social Security's actuarial imbalance. However, some people (such as blue-collar employees who commonly retire at a younger age) may need Social Security income to start at age 62. The reason the earliest eligibility age was lowered to age 62 in 1961 (1956 for women) was due to a lack of jobs and the large number of unemployed. A response might be that people need income only if they can't work, and the disability benefit is for that purpose. But some older people may not be able to get jobs if unemployment levels are high [5] or if they are disabled, but not quite enough for Disability Benefits. Finally, if proponents of keeping age 62 are correct, then they would be just as correct about some people needing the income at age 60. Should the eligibility age be lowered to 60 or 55 then? That would be expensive, and the benefits at age 55 would be very low.

Blue Collar Workers: As noted above, there is a concern for blue-collar workers (and others with strenuous jobs) who are often retired or laid off early. Increasing the retirement age affects these workers (and their employers) disproportionately. For example, if the NRA became 70, they would need their employer-sponsored pension plan to pay pension supplements for 5 more years. Employers will resist this due to the larger expense entailed. If pensions become much more expensive for these workers, employers may speed up the automation of their jobs. Alternatively, blue collar workers may need retraining to obtain another (and very different) job to tide them over that extra 5 years until they can get a full Social Security benefit. Getting a new job at an advanced age is quite difficult though, especially if your prior job was very different.

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[3] The early retirement reduction for spousal survivors at age 60 is frozen at 71.5% of the PIA by law.

[4] Disability benefits can be decreased too, if so desired. The PSA proposal suggested decreasing disability benefits by the same percent as retirement benefits payable at age 65. This would save 0.5% of covered payroll or almost 1/4th of Social Security's total financial problem. However, in 2083 when the NRA reaches 70, this proposal would reduce disability benefits by 30% from what someone retiring at age 70 would get.

[5] Unemployment levels may be low now, but what happens when they go back up? Could the eligibility age be indexed to unemployment levels for older workers?

Low Income Workers: There is also a concern for lower income workers who often don't save (or can't save) and who have little or no pension from their employer. For them, Social Security is their primary (and sometimes only) source of income in retirement. If they still retire at a young age, their Social Security benefits will be much lower, which makes it much more likely that their income will be below poverty levels. Establishing a minimum benefit will help them. Otherwise, they will have to work longer or resort to SSI (thus increasing Federal and State costs). This may not be as bad as it seems, since there are job opportunities for elderly workers, but they are more likely to be at low wages.

Minorities: There is also a concern for minorities that have lower life expectancies. This may actually be more a function of income level, and would apply to blue-collar workers too. They often do not live as long as white collar and higher income workers. This reduces the return on the contributions they made into the system. Some people say the benefits are regressive because of this. However, studies by Robert L. Brown at the University of Waterloo and other actuaries show that the progressive tilt in the Social Security formula (along with the disability and survivor benefits) more than offsets their shorter life spans. This would still apply after the change in retirement ages. A guaranteed minimum benefit could also help allay this concern.

Partially Disabled Older Workers. Another group of concern is the older person whose health is poor, but not poor enough to satisfy the disability definition. They will have a difficult time getting a job. Currently, if they are age 65 or older, they get a full benefit. In the future, that will not be so. Of course, determining whether someone is disabled is not easy, especially at older ages. But Social Security already has a more lenient rule for determining disablement at older ages in regulation § 404.1563, which may address this concern to some extent.

Finally, the number of unhealthy people at older ages is much less than the number of healthy people. Should they drive the retirement age policy for everyone? Maybe not, but we have to answer 3 questions:

(1) Can we work past age 67?

(2) Will we work past age 67? and

(3) Will employers keep us past age 67?

Can we work past age 67? Currently about 20% of men age 70 work. In 1940 (before Social Security), the workforce participation rate for males age 70 was almost 50% (see chart). If we are healthier now and jobs are less strenuous and unemployment is down, then maybe more than 50% could work now.

Older People are More Healthy Now than in the Past: Recent studies show that not only are we living longer, but we are healthier (physically and mentally) at older ages than people in the past. Rates of impairment among the aged are down.[6] Indeed, the average person age 70 now is probably healthier than the average person age 65 when Social Security was created. In addition, health issues can affect the retirement decision in different ways. The onset of a disability will induce us to retire, since we can't work any longer. Alternatively, if we are just healthy enough to work, there are incentives to work until we can get Medicare (or until we can get Post-Retirement Medical coverage through our employer plan, if sooner). If we can't get Medicare until age 70, it may encourage some of us to work until then.

Will We Work Past Age 67? Even if we can work past age 67, will we? We may just prefer to retire earlier. Retirement is not just a decision regarding our health, nor is it just a decision regarding our preference for leisure over work. It is also a financial decision. Many people don't have the finances to retire when they want. For example, work force participation rates in 1940 were high because the income was needed. In the 1960s, work force participation rates for men dropped dramatically because they could get a Social Security benefit at 62 (enacted in 1961 for men and 1956 for women) and Medicare was available (enacted in 1965). Employer Pensions and Post-Retirement Medical plans also help us retire early.

Do Later Retirements Increase National Productivity? Earlier retirements, of course, means the nation loses out on some of the productivity that our seniors could have given us. On the other hand, some productivity of a younger person could be lost, when unemployment levels are high. When someone retires, it opens up the possibilities of getting more productivity from younger people. Not only can the younger employee be more productive, by having the job (or a better job), but now they won't need to worry about supporting their parents.

[6] See Chronic disability trends in elderly US populations: 1982–1994 by Manton, Corder, & Stallard. In 1982, 14.1% of elderly between 65 and 74 were IADL (Instrumental Activities of Daily Living) or ADL impaired or institutionalized. In 1994 this decreased to 11.5%. For ages 75 to 84, it dropped from 31.9% to 26.9%.

Can We Be Encouraged to Work Longer? (and How?) Recently, however, work force participation rates have increased at age 70, possibly due to a relaxation of the Social Security earnings or retirement test.[7] At least some of us can work at age 70. Completely eliminating the retirement test after age 65 would encourage even more work. An attached chart shows that many older people have jobs that pay at the earnings limit. These people would probably work more, produce more, and pay more taxes if the limit were removed. While this proposal will increase current cash outlays (because some benefits would no longer be reduced), it doesn't hurt Social Security's long range financial problems.[8] That is because getting benefits sooner reduces future benefits (since they get less of an actuarial increase) and it would increase FICA tax income.

Smaller pensions from our employers may also cause us to work longer. For example, 401(k) plans don't subsidize pensions at younger ages, like traditional retirement plans. If you want to retire early, you will have to suffer the full actuarial reduction. This may force many people to work longer.

Higher retirement ages (for Social Security and Medicare) may encourage us to work longer, especially lower income workers who won't be able to retire for financial reasons. It may not affect wealthier people as much, because they can rely on their other resources.

Other proposals to decrease benefits may also encourage us to retire later. However, even though they are similar to proposals that increase the NRA, they may not register until too late. Most people don't know what their Social Security benefit amount is, so decreasing it won't affect their thinking now. Only when they reach age 65 will they realize how much the benefits dropped. At that point, they will finally realize that they have to work until a much later age. Thus, raising the retirement age could be the more effective way of making changes to Social Security. It is more likely to affect our thinking now than just decreasing benefits.

Congress Should Coordinate its Policies on Retirement Age: In addition, Congress should coordinate its national retirement policy, because right now it is sending inconsistent signals. Social Security is moving its retirement age to 67, but Medicare is still 65. In addition, the federal laws for employer-sponsored pension plans still use age 65. (Note: If Congress amended pension law to use the same ages as Social Security, some companies might take advantage of it. This could be a revenue raiser for the government, because employer contributions could go down—or at least not go up.) Another inconsistent signal is the requirement that IRA's and certain pension benefits begin their distributions by age 70½ even if the individual wants to continue to work. Raising the 70½ would defer government revenue however. You could also raise the 59½ age for earliest distributions, but that could discourage people from putting money into IRAs and 401(k) plans, since it would lock the money up longer. It would also be a revenue loser for the government. Of course, much of this depends on whether there are jobs for older Americans.

Will Employers Keep Us Past Age 67? Some employers believe that older workers may be less productive and less adaptable to change than younger workers. The older employees can limit the promotion possibilities of younger workers to the point that the younger employees may quit. Older employees' benefits may also cost more. An older worker's employee benefits (Health Insurance, Long Term Disability, Pension, Life Insurance, Annual Leave, and Sick Leave) could cost $10,000 more per year than those for a younger worker. On the other hand, not having to pay Post-Retirement Health benefits[9] and Pension benefits[10] while the older person is working could offset this amount. However, these cost reductions in Post-Retirement Health and Pensions don't apply to elderly employees who were recently hired. In fact, newly-hired elderly workers could increase employee health, post-retirement health, and pension costs (if they work long enough to become entitled to these retirement benefits). Laws that require their full coverage can make it a very costly

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[7] Workers over 70 can now earn a wage and not have their Social Security benefit reduced.

[8] See page 236 of Volume I of the 1994–1996 Advisory Council report—Item F.6.

[9] Post-Retirement Health plans would not have to pay amounts paid by their active employee health costs if they are between their earliest retirement age and age 65. If the employee is over 65, the employer plan would only benefit from the non-Medicare benefits that their post-retirement health plan would have paid. However, the active employee health plan would have to pay all health costs since Medicare is the secondary payer there. It would be difficult for Medicare to become the secondary payer to a post-retirement plan, because then employers would drop the plans. Employers can't drop their active life plan (unless they drop it for all active employees) because of ADEA.

[10] For example, the employee could lose a temporary supplement. Or costs could decrease if the employee is no longer accruing benefits due to a service maximum. If the employee is older than their NRA or the first age for unreduced benefits, their retirement benefit can be suspended while they are working, if they are notified.

decision for employers to hire older workers. If these laws were somewhat relaxed, employers might hire more older employees. For example, if an older worker can be hired at a lower salary that compensates for the extra cost of benefits, then cost will be less of an issue.

Employer Demand for Older Workers: An SSA publication by John Straka, The Demand for Older Workers, asserts that employers that limit the number of older workers (or reduce their earnings) do so for productivity and market efficiency reasons and not for prejudicial discriminatory reasons. He bases this on his theory that (ultimately) in an efficient market, people are paid what they are worth. He also says that job opportunities for older workers will be mostly confined to relatively low-paying, labor-hungry sectors and occupations such as certain retail and clerical work and part-time or temporary work (e.g., on holidays). These jobs may not be attractive to many elderly workers who once had well-paying jobs. His position is that the Age Discrimination in Employment Act (ADEA), shortages of younger workers, and SSA policies to encourage work will not be adequate to both get jobs for the elderly and safe-guard their well-being. He suggests more subsidized training and resources for older job searchers.

Labor Force Considerations: As noted above, the reason the earliest eligibility age was lowered from 65 to 62 was due to a lack of jobs and the large number of unemployed. However, because of today's booming economy and low levels of unemployment, this might not be as great a concern. In fact, if the Social Security retirement age is not changed, Social Security actuaries predict that the rate of increase in the labor force will continue to decline dramatically to less than 1% when the baby boom starts retiring. By 2008 it will be less than the annual increase in the population for the first time since 1960 (see chart). This could lower unemployment levels (something which may have already started happening). The lack of workers (i.e., supply) could push wages up, unless individuals become much more productive or unless we get more workers from other countries or can convince our older workers to remain in the job market. Employers may want to keep their older employees (at least part time). However, these good economic times may not last forever, so the rules need to work in times when unemployment isn't low.

Kinds of Jobs: Today's economy is more service-oriented (and less in need of heavy physical labor) than in 1940, which makes it easier for older individuals to work. Factors working in the other direction, however, include the rapid pace of change which makes it more difficult for older workers to keep up. (Training may not pay off if the worker might retire soon.) This may be particularly true of the many jobs in the high tech industry. These jobs are less physical, but they also change rapidly.

Part-Time Work and Phased Retirement: One way to help older employees to keep working would be to provide more part-time opportunities for them as they phase-out to retirement. However, many employers don't find part-time jobs very efficient, especially if they incur the same fixed overhead and benefit costs. It is also difficult to decrease an employee's pay by a substantial amount. One way to make this easier however, would be for Social Security to allow workers over age 65 to declare that they are switching to half-time, and request half of their Social Security benefit. Then it would be easier to pay them less. The federal retirement plans already do this. This declaration could replace the earnings or retirement test and be done in a way that is actuarially neutral to Social Security.[11] Essentially, this would be giving people more choice. People would choose their own retirement age and how to phase it in, and not Social Security through the earnings test, which people dislike. It would also bring in more payroll taxes than if the worker completely retired. Allowing employer pension plans to pay a partial pension while they are still working (in service benefit) would be important for consistency purposes too. Mechanisms would be needed to make sure that an employee's pension benefit is not hurt by low wages in their final years of employment (such as annualization of pay or indexing pay).

EFFECTS ON EMPLOYERS

Increasing Social Security's Normal Retirement Age will keep FICA taxes down, which employers will like. However, it may put more reliance for retirement benefits on the private pension system—employers and employees. Thus, employers with retirement plans may end up paying for the Social Security fix anyway, through high-

[11] For example, if a retiree receives 50% of his/her Social Security benefits, then the actuarial reduction (or actuarial increase) applicable at the commencement of the remaining half of their benefit would apply only to the remaining half of the benefit.

er pension contributions.[12] Employers without pension plans will get off free, unless their employees use this as a chance to demand a plan.

Alternatively, if employers don't improve their pension benefits, employees may end up working longer (if they can). An older work force will increase employer costs for other employee benefits (such as employee health, disability, life insurance, annual and sick leave) by as much as $10,000 per older employee that could have been replaced by a younger employee.[13] If employers don't want an older work force and the associated costs, they can lay off the older employees (always a difficult thing to do) or encourage them to retire by improving the company pension plan, which also will be costly.

Due to a huge increase in the number of retirements that will occur early in the next century, unemployment will probably continue to recede. When the labor force decreases in size (i.e., low supply), wages tend to increase. This could occur unless each worker becomes much more productive, or foreign workers are used. Later retirement ages (normal and earliest) in Social Security and employer pension plans could help reduce this concern. Employers may want to rethink their retirement strategies and encourage employees to stay on (at least part-time). Phased retirement may become popular, but IRS regulations [14] would need to be revised to allow in-service distributions to be payable before a pension plan's Normal Retirement Age. In addition, it is quite difficult for employers to increase their Retirement Ages in tandem with Social Security, unless pension law allows higher normal retirement ages than age 65 and relaxes the rules against decreasing benefits.[15] Otherwise, employers will have to calculate 2 separate pension amounts for service before and after each change in the retirement age. This will be very complex. It appears that Congress can increase Social Security retirement ages the easy way, but they won't allow employers to. Finally, decreased Social Security benefits could necessitate changing the nondiscrimination rules to reduce the disparity in benefits.

Effects on the Social Security System

Increasing the Normal Retirement Age would significantly reduce Social Security's long-term deficit and could add additional years of solvency to the trust fund. For example, gradually increasing the NRA to age 70 would solve about half of its financial problems. Increasing the NRA to age 73 would nearly eliminate the deficit.

Increasing the earliest retirement age would reduce outlays (creating more surplus) in the years that it is implemented. It would also solve about 10% of the long-term deficit. This occurs even though the early retirement reductions are actuarially equivalent,[16] because they only compensate for the fact that the recipient gets the benefits for more years. It doesn't compensate for the fact that Social Security will get tax contributions for fewer years.[17] This is particularly significant if the NRA moves to age 70 and the Earliest remains at 62.

Indexing the Normal Retirement Age to increases in longevity (for example, by 1 month every year or two) would keep the system from going out of balance due to longer life spans. Then Congress wouldn't have to continually readdress this painful issue of fixing Social Security every 20 years, unless the economy went sour or birth rates decreased dramatically.

Medicare, on the other hand, is not helped as much by an increase in its Retirement Age. For example, age 70 would reduce Medicare's deficit by only 0.3% of payroll or about 15% of its long-term deficit (Hospital Insurance only). This is because (1) disabled people would continue to get the Medicare benefits anyway and (2) most of HI's expenses are at very old ages. This also points out, however, that most of us are quite healthy between the ages of 65 and 70. Changing just Social Security's NRA to 70 (and not Medicare's) would also help HI's deficit, because Medicare is

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[12] Social Security Offset plans (and plans with temporary supplements to the Social Security NRA will automatically get more expensive, unless employers amend them.

[13] Retaining older employees could decrease post-retirement health costs, but this would be offset to the extent that Medicare also increases its retirement age. Pension costs could also decrease for employees over the Normal Retirement Age (unless actuarial increases are provided along with accruals).

[14] For example, § 1.401–1(b)(1)(i) requires that retirement plans be exclusively for retirement and other incidentals.

[15] See the definition of Normal Retirement Age (65 & 5) in § 411(a)(8), the maximum distribution age of 70½ for owners in § 401(a)(9), the anti-cutback rule in § 411(d)(6), and the commencement rules (65 & 10) in § 401(a)(14).

[16] Social Security's actuarial reductions are somewhat liberal when interest rates are high.

[17] One way to remedy this is to determine average earnings over 40 years instead of over 35 years, as is currently done. However, Congress might want to allow drop out years for years of pregnancy and child care. There is already a rule for this in certain disability calculations.

a secondary payer to employee health plans), but it would be less than the 15% solution cited above.

All the above changes also encourage people to work longer. If the right jobs are available, this could increase the nation's productivity. This in turn increases both FIT and FICA/SECA taxes, which is good for government and can help us either lower taxes or improve other government programs.

WHAT SHOULD THE NORMAL RETIREMENT AGE BE?

The last question is "If we do increase the retirement age, what should it be?" Here are some choices.

Keep the NRA at age 65. It might be easier to understand this question if we look at extremes. Suppose for example that we lived on average to age 110. If the NRA stayed at age 65, we would receive benefits for 45 years on average, or as many years as we worked. Dependency ratios could be around one (1) worker per beneficiary, which is much worse than today. Thus, the system would be very expensive. In addition, indexed life annuities at age 65 might cost 90% more than they do today. Thus, a funded system would also be very expensive, because we would have to save 90% more over the same 45 year working lifetime to get the same replacement ratios. It's easy to see the financial difficulties with keeping the retirement age fixed at 65 forever.

Pay Benefits for the Same Number of Years. Thus, one might consider indexing the retirement age, just like we now index the initial benefit to productivity levels at retirement. One way to do it would be for Social Security to provide benefits for the same number of years (i.e., keep the life expectancy at NRA the same). When Social Security was created, life expectancies at 65 were about 12.7 years.[18] If we used this method, the NRA would be around age 72 today. It would have gone up 7 years in 6 decades. In that case, the ratio of workers to beneficiaries would continually go up and thus the costs of our unfunded system would generally decline under this suggestion. Similarly, in a funded system, the costs of buying the indexed annuity would remain the same. However, since it can now be funded over 7 more years (i.e., ages 65 to 72), the annual amount that needs to be saved would continually decrease.

Keep the ratio of years in retirement to the working lifetime the same. Another way to index the retirement age would be to determine the age that maintains the same ratio of retirement years to working years. This could be accomplished in several ways. One example would be to divide the life expectancy at NRA by the potential years worked (e.g., the years from age 20 to 65). This would be a compromise between freezing the NRA at 65 (which would dramatically increase costs) and freezing the life expectancy at NRA (which could dramatically decrease costs). In fact, it was recommended by a majority of the members of the 1983 National Commission on Social Security Reform. This idea could stabilize the costs of the system and it wouldn't go out of balance every year as another deficit year was added to the 75-year projection. If this idea had been used since the creation of Social Security, the NRA would be age 70 now. This is an easy calculation. However, it doesn't reflect whether our health is continuing to improve also. This could be handled by using a health index. For example, we could look at the disablement rates (or some sort of health index) at the NRA and prohibit an increase if the rates (or index) were getting worse. However, this has problems. A health index could be quite subjective and it could trap us into setting different Retirement Ages for men and women, and for different worker classifications, minorities, or income levels. Multiple retirement ages and provisions are some of the reasons the Chilean and other foreign systems were collapsing, so we may not want to open that Pandora's box.

Maintain Same Cost Levels: Another method would be to use the calculation of the NRA to maintain a level cost for the system. Other similar methods would be to maintain the same dependency ratio of workers to retirees. In a funded system, it would require an actuarial calculation to maintain the same contribution or savings rate for each person. However, these methods entail a much more difficult calculation, and it would depend on many different assumptions about the future. For example, it could mean that the NRA could go up even if we weren't living longer—for example, if fertility rates declined or if the economy got worse. That might not be appropriate. In fact, it might be more appropriate for those variables to affect

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[18] The Trustees' report uses composite life expectancies based solely on the death rates for the year in question. Actual life expectancies (with an assumed mortality improvement) for people living in that year might be more appropriate, especially in a funded system.

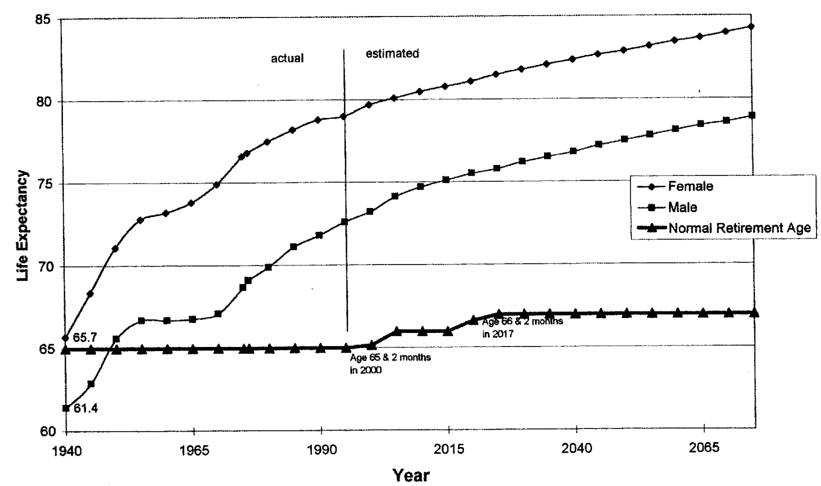
the tax rates. For example, if national birth rates decline, then maybe we should contribute more, not raise the retirement age.[19]

CONCLUSION

Raising the retirement age is a difficult decision and gives us much to consider. We can't move ahead with it unless the people understand Social Security's financial problems and the effects of increasing the Retirement Age. It seems like an obvious fix since people are living so much longer. However, if raising the retirement age does not work because (1) many elderly people can't work longer (because of health reasons or mental inability), or (2) a huge percent just end up with disability benefits, or (3) the elderly can't get a job for lack of demand, or (4) because people perceive too little value for their contributions, then we will need to find other ways to fix Social Security. Whether privatization or focusing more benefits on low income workers (and reducing benefits for higher income workers) will solve the problem is unclear. What is clear however, is that Social Security will cost us a lot more if we cannot increase the retirement age (or decrease benefits). We would suggest that Congress use 1998 to educate the public and sufficiently consider all of the ramifications of any possible solution. Once again we commend the subcommittee for taking a leading role in educating the public on a very complex, but important topic.

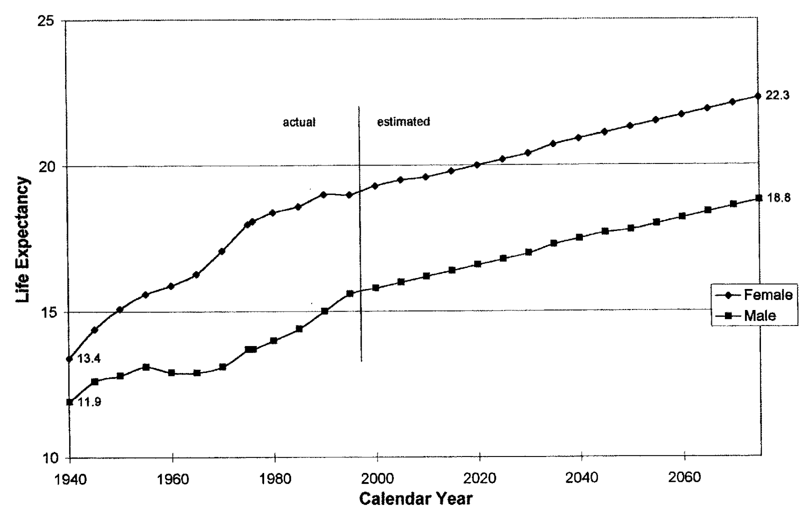
[19] Congress could index the system now, or wait until the problems occur. If they decided to index, there would need to be rules on how big the problem would have to be before change occurred, and how to phase it in gradually. Changes could be subject to an override by Congress and would need a cap on how much change could occur and how often a change could occur. There are many issues which would have to be worked out on this.

Life Expectancies at Birth



Source = 1997 SSA Trustees' Report page 63 (Intermediate Assumptions) 2/24/98

Life Expectancies at Age 65



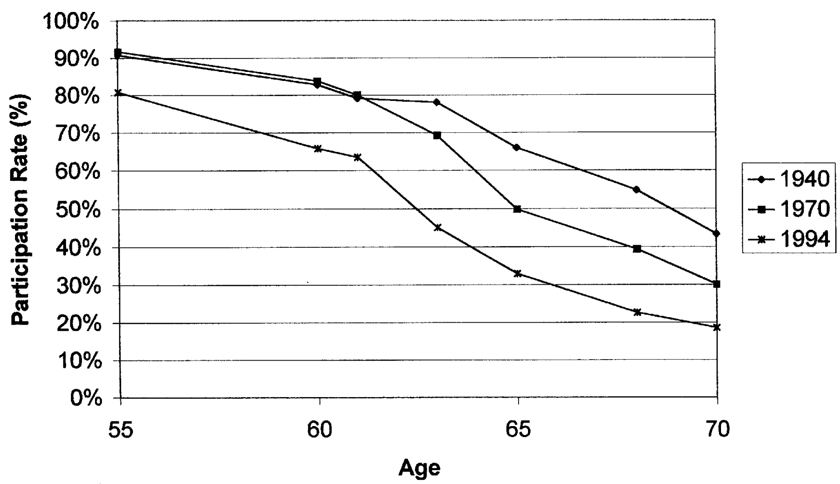
Source = 1997 SSA Trustees' Report page 63 (Intermediate Assumptions) 2/24/98

Table 1.E – Comparison of Earliest Elibility Age (EEA) and Normal Retirement Age (NRA) for OASDI

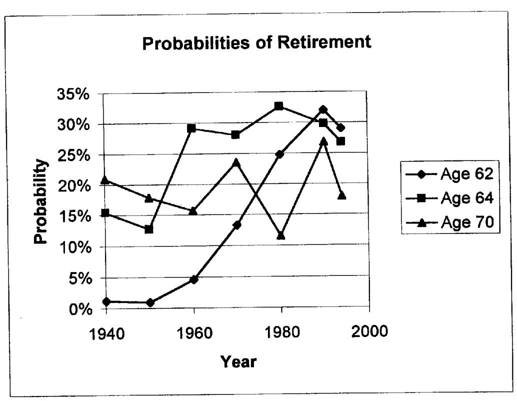
Birth	Year	Year	Present Law		MB Plan		1.6% IA Plan		5% PSA Plan	
Year	Age 22	Age 62	EEA	NRA	EEA	NRA	EEA	NRA	EEA	NRA
1933	1955	1995	62	65	62	65	62	65	62	65
1934	1956	1996	62	65	62	65	62	65	62	65
1935	1957	1997	62	65	62	65	62	65	62	65
1936	1958	1998	62	65	62	65	62	65	62	65
1937	1959	1999	62	65	62	65	62	65	62	65
1938	1960	***2000***	62	***65:02***	62	65:02	62	65:02	62:02	65:02
1939	1961	2001	62	65:04	62	65:04	62	65:04	62:04	65:04
1940	1962	2002	62	65:06	62	65:06	62	65:06	62:06	65:06
1941	1963	2003	62	65:08	62	65:08	62	65:08	62:08	65:08
1942	1964	2004	62	65:10	62	65:10	62	65:10	62:10	65:10
1943	1965	2005	62	66	62	66	62	66	63	66
1944	1966	2006	62	66	62	66	62	66:02	63:02	66:02
1945	1967	2007	62	66	62	66	62	66:04	63:04	66:04
1946	1968	2008	62	66	62	66	62	66:06	63:06	66:06
1947	1969	2009	62	66	62	66	62	66:08	63:08	66:08
1948	1970	2010	62	66	62	66	62	66:10	63:10	66:10
1949	1971	2011	62	66	62	66	62	67	64	67
1950	1972	2012	62	66	62	66	62	67	64	67
1951	1973	2013	62	66	62	66	62	67:01	64:01	67:01
1952	1974	2014	62	66	62	66	62	67:01	64:01	67:01
1953	1975	2015	62	66	62	66	62	67:02	64:02	67:02
1954	1976	2016	62	66	62	66	62	67:02	64:02	67:02
1955	1977	2017	62	66:02	62	66:02	62	67:03	64:03	67:03
1956	1978	2018	62	66:04	62	66:04	62	67:03	64:03	67:03
1957	1979	2019	62	66:06	62	66:06	62	67:04	64:04	67:04
1958	1980	2020	62	66:08	62	66:08	62	67:04	64:04	67:04
1959	1981	2021	62	66:10	62	66:10	62	67:05	64:05	67:05
1960	1982	2022	62	67	62	67	62	67:05	64:05	67:05
1961	1983	2023	62	67	62	67	62	67:06	64:06	67:06
1962	1984	2024	62	67	62	67	62	67:06	64:06	67:06
1963	1985	2025	62	67	62	67	62	67:07	64:07	67:07
1964	1986	2026	62	67	62	67	62	67:07	64:07	67:07
1965	1987	2027	62	67	62	67	62	67:08	64:08	67:08
1966	1988	2028	62	67	62	67	62	67:08	64:08	67:08
1967	1989	2029	62	67	62	67	62	67:09	64:09	67:09
1968	1990	2030	62	67	62	67	62	67:09	64:09	67:09
1969	1991	2031	62	67	62	67	62	67:10	64:10	67:10
1970	1992	2032	62	67	62	67	62	67:10	64:10	67:10
1971	1993	2033	62	67	62	67	62	67:11	64:11	67:11
1972	1994	2034	62	67	62	67	62	67:11	64:11	67:11
1973	1995	2035	62	67	62	67	62	68	65	68
1974	1996	2036	62	67	62	67	62	68	65	68
1975	1997	2037	62	67	62	67	62	68:01	65	68:01
1976	1998	2038	62	67	62	67	62	68:01	65	68:01
1977	1999	2039	62	67	62	67	62	68:02	65	68:02
1978	2000	2040	62	67	62	67	62	68:02	65	68:02
1979	2001	2041	62	67	62	67	62	68:03	65	68:03
1980	2002	2042	62	67	62	67	62	68:03	65	68:03
1981	2003	2043	62	67	62	67	62	68:04	65	68:04
1982	2004	2044	62	67	62	67	62	68:04	65	68:04
1983	2005	2045	62	67	62	67	62	68:05	65	68:05
1984	2006	2046	62	67	62	67	62	68:05	65	68:05
1985	2007	2047	62	67	62	67	62	68:06	65	68:06
1986	2008	2048	62	67	62	67	62	68:06	65	68:06
1987	2009	2049	62	67	62	67	62	68:07	65	68:07
1988	2010	2050	62	67	62	67	62	68:07	65	68:07
1989	2011	2051	62	67	62	67	62	68:08	65	68:08
1990	2012	2052	62	67	62	67	62	68:08	65	68:08
1991	2013	2053	62	67	62	67	62	68:09	65	68:09
1992	2014	2054	62	67	62	67	62	68:09	65	68:09
1993	2015	2055	62	67	62	67	62	68:10	65	68:10
1994	2016	2056	62	67	62	67	62	68:10	65	68:10
1995	2017	2057	62	67	62	67	62	68:11	65	68:11
1996	2018	2058	62	67	62	67	62	68:11	65	68:11
1997	2019	2059	62	67	62	67	62	69	65	69
1998	2020	2060	62	67	62	67	62	69	65	69
1999	2021	2061	62	67	62	67	62	69:01	65	69:01
2000	2022	2062	62	67	62	67	62	69:01	65	69:01
2001	2023	2063	62	67	62	67	62	69:02	65	69:02
2002	2024	2064	62	67	62	67	62	69:02	65	69:02
2003	2025	2065	62	67	62	67	62	69:03	65	69:03
2004	2026	2066	62	67	62	67	62	69:03	65	69:03
2005	2027	2067	62	67	62	67	62	69:04	65	69:04
2006	2028	2068	62	67	62	67	62	69:04	65	69:04
2007	2029	2069	62	67	62	67	62	69:05	65	69:05
2008	2030	2070	62	67	62	67	62	69:05	65	69:05

Office of the Actuary, Social Security Administration
October 28, 1996

Labor Force Participation Rates

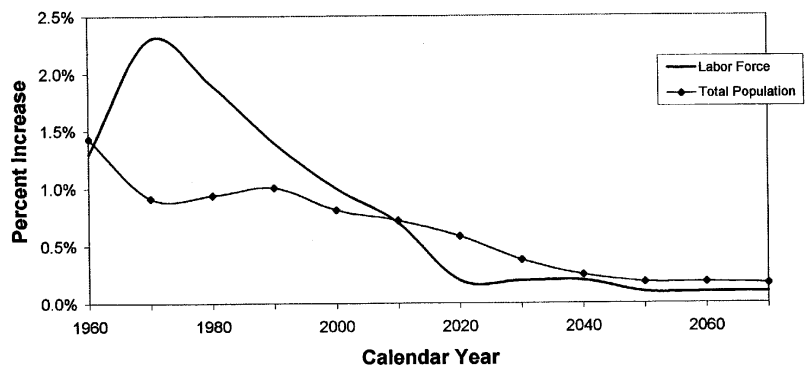


YEAR	$_2q_{61}$	$_2q_{63}$	$_2q_{68}$
1940	1%	15%	21%
1950	1%	13%	18%
1960	5%	29%	16%
1970	13%	28%	24%
1980	25%	33%	12%
1990	32%	30%	27%
1994	29%	27%	18%



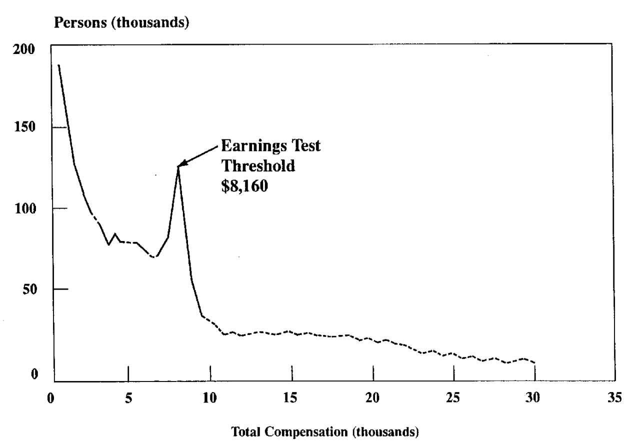
Data Sources: 1940 - 1960 US Census, DOL stats from CPS and Richard Burkhauser
Rates of Retirement were much lower in the past at age 62, before SSA benefits were payable at 62 (enacted in 1956 for women and 1961 for men), and Medicare available at age 65 (enacted in 1965).
Have retirement rates peaked? Are they coming down? Are people starting to work longer?

Average Annual Increases in Labor Force and Population



Data Source: 1997 SSA Trustees Report, pages 60, 124, & 148.
Note: Due to smaller increases in labor force, employers may stop encouraging employees to retire. Unemployment will decrease.

1988 Retiree Earnings Patterns, OASI Beneficiaries and Fully Insured Nonbeneficiary Workers, Aged 65–69



Source: Continuous Work History Sample
Leoneslo (1991)

Figure II-7

Social Security Advisory Council Proposals

Provision		Change in Long-Range OASDI Actuarial Balance Over 75 Years: Maintain Benefits (MB)	Individual Account (IA)	Personal Security Account (PSA)
0.	Reflect BLS changes in the CPI	0.31	0.31	0.31
1.	Cover all state and local employees hired after 1997	0.22	0.22	0.22
2.a.	Tax Social Security (OASDI) benefits like other contributory defined benefit plans	0.15	0.15	—
2.b.	Phase out benefit taxation thresholds by 2007	0.16	0.16	0.16
2.c.	Redirect revenue from taxation of benefits from Medicare (HI) to Social Security (OASDI), 2010-19	0.31	—	—
3.	Increase benefit computation years from 35 to 38 by 1999	0.28	0.28	—
4.a.	Increase Normal Retirement Age to 67by 2011 and index thereafter	—	0.50	—
4.b.	Same as 4.a. but raise Earliest Eligibility Age (EEA) to 65 and lower diability benefits by 30 percent	—	—	1.25
5.	Reduce benefit calculation factors from (90, 32, 15) to (90, 22.4, 10.5) by 2030	—	1.32	—
6.	Reduce spouse benefit from 50 percent to 33 percent	—	0.17	—
7.	Provide 75 percent of couple benefit to survivor	—	-0.32	-0.39
8.	In 1998, require 1.6 percent contribution to IA	—	0.00	—
9.	Replace with a flat benefit of $410 in 1996	—	—	3.82
10.	Eliminate the earnings test at NRA	—	—	0.00
11.	Increase payroll tax by 1.52 percent, 1998–2069	—	—	1.42
12.	Borrow from General Fund 2002–3, pay back by 2070	—	—	0.00
13.	Redirect 5 percent of tax to PSAs	—	—	-4.60
14.	Invest 40 percent of trust funds in stocks by 2015	0.82	—	—
15.	Increase payroll tax by 1.6 percent in 2045	0.22	—	—
Total		2.42	2.57	2.18

Source: Office of the Actuary, Social Security Administration, March 18, 1997

Chairman BUNNING. Thank you very much.

I'd like, since we have another panel to follow, and some of us have other places to be, Dr. Burkhauser, in your testimony, you seem the most convinced, out of all our panelists today, that not only is it possible for Social Security policy to encourage workers to stay in the work force longer, but that changes in the public policy in a strong economy have already ended the trend toward early retirement. At least that's what I heard you say.

Would you provide more details as to how you reached this conclusion? And do your conclusions differ based on specific cohorts by gender or by ethnic background?

Mr. BURKHAUSER. These aren't my statistics. These come from the Current Population Survey, which looks at the labor force participation rates of men and women by age group. If you go through some of the tables in my formal statement, you'll see that, since 1985, the trend toward lower labor force participation rates, which had gone on since the fifties, has stopped, and in fact in certain age groups over the age of 62 they actually increase. For women, that's happening mainly because labor force participation rates of younger women are rising, and therefore, there are more women in the labor force in their fifties. For men, I believe it's occurring because men are not so much staying longer at their career jobs, but are working in a new job after they've left their career jobs.

The evidence is now very strong that this trend toward earlier and earlier retirement is over, and it's in part due to the 1983 Social Security Amendments which have reduced a lot of the biases in the Social Security system against working at older ages. Congress has raised the actuarial adjustment after age 65. You've also raised the earnings test amounts, and these signals that work will be rewarded have been picked up. Older people are working more because of them.

Chairman BUNNING. Do you think the employer also adjusts?

Mr. BURKHAUSER. I think that employers are very sensitive to the rules of the game. For instance, a few years ago, to save some money, Congress changed the way that Medicare payments were paid. Medicare used to be the first provider of health insurance for older people. To save some money for the government, Congress made private employers the first payer. If you look at where the jobs are increasing for older people, they're mostly in companies that don't have health insurance because in those companies, whether you're old or young doesn't make any difference. If you wanted to do something about allowing older workers to stay longer in the workplace, go back to making Medicare the first provider of health care. Don't penalize workers by lowering the value of their Medicare protection because they want to work.

Mr. BERNSTEIN. Mr. Bunning, may I comment on that? I agree with that. It's in my prepared testimony, that the Medicare requirement's not only for retirees, but for their dependents, create a hurdle for the continued employment of older people.

Chairman BUNNING. Under a program where the employer furnished medical benefits?

Mr. BERNSTEIN. That's correct.

Chairman BUNNING. OK.

Mr. BERNSTEIN. I would point out also that Social Security probably plays a much more minor role than private pensions do. That's the import of the data presented by Dr. Burkhauser. Footnote 3 of his statement, he says, "Unless major changes take place in employer pensions, these changes alone in Social Security will have only a minor effect on employment."

Mr. GEBHARDTSBAUER. Mr. Chairman, I was just wondering if I could add one thing. Employer pension plans right now often have used 65 as the age for retirement, and the laws in the pension law right now make it very difficult to increase that. Congress has increased Social Security's retirement age to 67, but it's more difficult for employers to do something like that now. And you might consider some consistency there in allowing employers to do the same thing.

Chairman BUNNING. Most employers set that as the normal retirement age, but they allow you to take early retirement, just like Social Security, with a lesser pension or a lesser program actuarially from the 65 years. The buyouts and things that are being offered by major corporations are trying to get people to age 65, generally speaking.

Mr. BERNSTEIN. Frequently, though, when they permit people to go out, to retire before age 65, it's without actuarial reduction, frequently.

Chairman BUNNING. Well, as an incentive to get them out.

Mr. BERNSTEIN. No, as a regular proposition.

Chairman BUNNING. I haven't run into many of those people.

Mr. Portman.

Mr. PORTMAN. I want to thank the panelists. I have a lot of questions, but I'm really intrigued by this notion that was raised by Mr. Gebhardtsbauer at the end about part-time work and phased retirement and getting back to the earnings limit discussion that we started to have earlier with the Commissioner.

I've read your testimony on it, and I've heard what you have to say. You've obviously given this some thought, and I think it would be helpful to the Subcommittee if you would flesh it out even further.

But I think what you're saying—and correct me if I'm wrong—is that, particularly as we get beyond this 2008 crossing of the lines where there will be more encouragement naturally among employers to keep older workers and to provide opportunities for them, is to allow people to take a part of their benefit, maybe half of their Social Security benefit, and continue to work. In essence, that would replace the earnings limit. It would have an impact similar to the earnings limit, but not as onerous, because they could still get half their Social Security benefit. So, in essence, the benefit would be postponed, but they'd be working part time.

What would the impact be on the Social Security system? Have you analyzed that?

Mr. GEBHARDTSBAUER. OK, thank you for asking. By the way, the reason why I came up with this idea, or some of us came up with the idea initially, was regarding choice. In the individual account area you have more choice in your retirement age than in the Social Security area. I thought, well, what's the concern there? I realized, oh, it's the earnings test. That's sort of Social Security telling you when you really are retiring. If you're earning some money, then you really haven't, so they deduct something from your benefits.

Mr. PORTMAN. I guess one of the intriguing parts about it—it does give older Americans more choice.

Mr. GEBHARDTSBAUER. Right.

Mr. PORTMAN. Many, perhaps, as Mr. Bernstein was saying earlier, don't feel they, in fact, have.

Mr. GEBHARDTSBAUER. In addition, as you point out, if we get to the point where employers want more labor, they may use this idea to keep their part-time employees, because, as we mentioned earlier, it's more expensive to have them, but if you can reduce their pay, then the expense doesn't go up. So it helps you keep people around working, but the payroll doesn't continue to go up, and have all these more expensive benefits.

Finally, how would you do it? You said it pretty clearly. Like the Federal plan, for instance, a retiree can come back to work and work, say, 60 percent, 3 days a week and get 40 percent of their Federal benefits.

And, finally, the effect on Social Security, right now we've talked about how you have a delayed retirement credit. It's sort of an actuarial increase. If you work longer and don't get a benefit, then your benefit is much larger when you actually do get the benefit. So by getting the benefit now, you're getting less. So in the long run, it's about the same amount of money if the actuarial reduction is about right or if the actuarial increase is about right.

There are a couple of other concerns, and I wanted to mention them earlier. And one is that there are other reasons why you improve your benefit, if you continue to work, and that is, you continue to improve your 35-year average salary. But after a certain point, after you've gotten 35 years, it doesn't really help you that much. So you might want to consider changing that to make it more cost neutral to Social Security, so that it becomes something like a 40-year average instead of a 35-year average. That would make it even more cost neutral.

But initially, you would have the problem that more people would be getting benefits now, and so cashwise up front and short term it is a little bit more expensive. But in the long run, it's cost neutral to Social Security.

Mr. PORTMAN. Because of the fact they would be paying in during that period as well, and not taking the benefit as soon?

Mr. GEBHARDTSBAUER. Right.

Mr. PORTMAN. Dr. Myers.

Mr. MYERS. With regard to the suggestion that the computational period ought to be extended and be longer than 35 years and go up to 40 years, I think this would be very undesirable because it would primarily affect women workers, because they have enough trouble getting 35 years, of covered employment, considering that many of them are homemakers for a while. So I think increasing the averaging period would be a step in the wrong direction.

Mr. GEBHARDTSBAUER. I have something in my testimony that speaks to that, because that's a very good point. What you would do is you would have dropout years for women for child care, for reasons like that, you drop out the years. So instead of having 40, they would get 40 minus 5, or 35, if they had 5 years of child care and pregnancy. In fact, that's already done in the disability area a little bit. So it's not something that would be impossible to do.

Mr. BURKHAUSER. You should be careful about whether it affects homemakers, though. Most homemakers are married. Their benefits are based primarily on their husband's earnings, not on theirs. What they pay into the system, They often get no additional benefits out of what they pay into the system, and there are almost no women whose survivors' benefits are based on their own contributions; almost they are based solely on their husband's.

Mr. GEBHARDTSBAUER. And that's another area where you should be looking into making changes to the system.

Mr. PORTMAN. I'm making a general comment. I think what we talked about today in terms of the earnings limit and its replacement by something like this has a lot of potential, and obviously it has an impact on pension policies, you said, and I agree with you on the age 65 and the pension policy. That's quite controversial, and we need to be sure it was done in concert with these other things.

In Medicare, as you said—it reminds me a little bit of the welfare debate. To get people to work and to encourage people to work, it needs to be looked at at a much broader context. So I hope that you can provide some more information on that, and other panelists as well.

I'm going to ask one final question, and I'm going to put it out on the table here at the start, Mr. Chairman. I'm 42. Can we go through the panel here—is this a privacy matter that we shouldn't get into? Dr. Myers, can you tell us your age?

Mr. MYERS. Yes, 85.

Mr. PORTMAN. Eighty-five?

Mr. Bernstein.

Mr. BERNSTEIN. Next month I'll be 75.

Mr. PORTMAN. Seventy-five. You're 85 and 75. I want to commend you both for your excellent testimony today.

Dr. Burkhauser, you called yourself a baby boomer.

Mr. BURKHAUSER. Fifty-two.

Mr. PORTMAN. Fifty-two—we'll let you in on the edge.

Mr. BURKHAUSER. OK.

Mr. GEBHARDTSBAUER. And I'm in the middle of the baby boom; I'm 45.

Mr. PORTMAN. All right, thank you, Mr. Chairman. Thank you, gentlemen.

Chairman BUNNING. Gentlemen on this panel, I want to make sure you understand that we may submit further questions in writing to you, since we have another panel following you. Thank you for your testimony.

[Questions were submitted by Chairman Bunning to Mr. Myers. The questions and responses follow:]

Question 1. In your testimony you say that you believe that as people live longer, they should and will be able to work longer. Thus the definition of retirement age should be a dynamic one. Yet, Dr. Myers, we know that last year three/fourth of those who retired, retired early. Do you see it as the Congress's job to require people to stay in the workforce? While older individuals may in fact want to stay in the workforce, how can we be sure that employers will make jobs available?

The first question relates to my belief that, as people live longer, they should and will be able to work longer. I fully realize that, currently, most people retire early and that, in the future, they may wish to also do so. However, the Social Security program and its financing should not be an undue burden on the working population, and its costs should not be excessive because of people's early retirement. If people wish to retire early, they should finance it themselves.

Question 2. You mention that current law provides just over a 10-year plateau at age 66 before the retirement age begins gradually moving up again to reach 67. Would you provide more details as to why the law provides for this plateau?

The second question relates to the 10-year plateau in the full-benefits retirement age when it first reaches age 66. This was done in the 1983 Act, rather than going continuously up to age 67, because the latter course of action would have produced a significant estimated positive long-range actuarial balance (or surplus), and the intention underlying the legislation was to have a very close to zero actuarial balance result.

Question 3. You propose eliminating the plateau in current law, and also continuing increasing the retirement age by two months for each year of birth indefinitely into the future. You also advocate for raising the early retirement ago once the normal retirement age hits 67, so that it is always 5 years lower than the normal retirement ago. The remainder of the long-term deficit in your view, could be made up by what you consider "noncontroversial" changes such a covering all new State and local government employees, making the provisions for income-taxing benefits the same as are applicable to pensions, and correcting the consumer price index. Most, if not all of these "fixes" are controversial, and translate into real benefit cuts for our young people today. Do you have any suggestions for program changes that would be embraced by young people?

The third question relates to what I referred to as "noncontroversial" changes. I used this phrase because all such changes were agreed to unanimously by the recent Advisory Council on Social Security. I believe that these changes are reasonable and are fair to young people. As to changes which would be embraced by young people, within the context of the present program, most persons like neither benefit-cost reductions or tax increases, and yet one or the other (or both) seem to be needed.

Question 4. I'm interested in knowing your views on the degree to which age discrimination may ultimately prevent increased participation of older workers in the work force.

The fourth question relates to possible age discrimination ultimately preventing the increased participation of older workers in the work force as the full-benefits retirement age is increased. Because such increase is very gradual, I believe that, in one way or another, such discrimination will not occur, as the country (and especially the employers) realize that this should not occur, in the best interest of all concerned.

Question 5. Will there be enough jobs for older workers, jobs with the level of physical activity that most persons over age 67 can perform?

The fifth question relates to whether there will be enough jobs for older workers, considering the level of physical activity which they will have. I believe that, as in the past, there will be fewer and fewer jobs requiring a high level of physical activity. Even more importantly, I think that, as longevity increases, so too will the ability to do physical activity at any particular age (e.g., in the distant future, a person aged 70 will have at least as much ability to do physical activity as can a person aged 65 today).

Question 6. Do you have thoughts on how the increasing number of older workers might impact rates of unemployment, job opportunities, and career advancement for younger workers?

The sixth question relates to whether the increasing number of older workers might impact rates of unemployment, job opportunities, and career advancement for younger workers. Considering that the relative (but not necessarily, absolute) number of younger workers will decrease over the long run, I believe that a gradual increase in the number of older workers as the full-benefit retirement age rises, would likely work out equitably for both younger and older workers. Obviously, if older workers tend to continue retiring at age 65 (or even earlier), this would be more favorable job-wise for younger workers (although they would have to pay more, directly or indirectly, for the support of the aged population). However, I think that a good and equitable balance as to employment conditions would develop as between younger and older workers.

[Questions were submitted by Chairman Bunning to Mr. Gebhardtsbauer. The questions and responses follow:]

1. In your testimony, you discuss the importance, when increasing the retirement age of avoiding any sudden decline in benefits, and therefore avoiding a "notch." How was this avoided in the 1983 amendments and how can we be sure to avoid it in the future, should an increase in the retirement age occur?

There were many changes in the 1983 amendments that did not decrease benefits and thus avoided the notch problem. However, it did increase the Normal Retirement Age (NRA), or age for full benefits, which could be perceived as a decrease in benefits, if someone still takes their benefit at the same age. As I stated in my testimony (including footnote 1), if someone born in say 1938 "still retires at age 65, their retirement benefit will be about 1% lower [1] than if the Normal Retirement Age had remained at age 65. If the NRA had increased to age 66 all in one year, benefits would have dropped immediately by about 7%. This large decrease would be similar to the notch baby benefit decreases which caused much alarm among the elderly in the 1980's. Phasing in the increase in retirement age over 6 years from 2000 to 2005 avoids this problem." As I stated in my footnote, when wage increases exceed the CPI, it reduces (and can eliminate) the size of the notch. By a notch, I mean someone getting a benefit in early January that is less than a similar person (born a week earlier) retiring in late December of the prior year. In addition, the change was delayed until the year 2000, so not much fuss was made over this change in 1983. It only affected people who were age 45 or younger at the time. That was probably more than enough lead time back then.

Some people do not consider increasing the retirement age as a decrease in benefits because we are living longer. They would contend that future retirees will live longer than current retirees, and thus get benefits for just as many (or more) years. In town hall meetings across the country sponsored by Americans Discuss Social Security and the Pew Charitable Trusts, we have found that people don't categorize "Increasing the Retirement Age" with benefit decreases. In electronically-taken votes, people ranked the 3 major benefit decreases (benefit decreases across the board, reduced COLAs, and increased taxes on Social Security benefits) at the bottom of 10 options, while ranking "Increase the Retirement Age" at 3rd from the top. See chart showing rankings at the forums.

Thus, ways to avoid the notch problem are to:

(a) Phase-in each one-year increase in Normal Retirement Age over 6 years (4 years might be enough, if wage increases are expected to exceed the CPI by more than 1%), and

(b) Delay its effective date (so that near-retirees who are already planning their retirement are not affected).

Other ways, of course, are to not decrease benefits directly (e.g., increase payroll taxes, increase coverage, increase taxes on benefits, delay or reduce COLA's, or decrease the benefits of a small group, etc.).

2. What are the advantages to creating a minimum benefit level through Social Security reform and how would that work? What are the advantages and disadvantages?

We will respond to this question, by analyzing the proposal for a minimum benefit equal to 100% of the poverty level from the National Commission for Retirement Policy (Center for Strategic and International Studies).

Minimum Benefit would offset benefit decreases to low paid: Under the CSIS/NCRP proposal, Social Security would provide a minimum benefit equal to 100% of the poverty level (currently almost $8,000 per year), beginning in 2010. This would offset to some degree changes in their proposal that decrease benefits (e.g., Increasing the Normal Retirement Age (NRA), using more years in Average Indexed Monthly Earnings (AIME), BLS reductions in the CPI that is used for indexing benefits, reducing survivor benefits, reducing the benefit formula, no mandatory annuitization or pre-retirement withdrawal restrictions [2]).

Cost: Of course, a minimum benefit also increases costs, but probably not as much as expected, due to the progressive nature of the benefit formula and subsidies in spousal benefits.[3] It would reduce the costs of the Supplemental Security Income (SSI) program.

Disincentives to Work: Flat minimum benefits can create a disincentive to work, once their eligibility rules have been satisfied. (After that point, the marginal money's worth can drop to zero for awhile.) The NCRP proposal reduces this concern

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[1] Since people born in 1938 get their wages indexed one more year than people born in 1937 (and one less COLA), there is little likelihood that a notch will occur (assuming the wage index for 1997 wages will be more than the COLA in 1999). Even a 4 year phase-in would probably not create a noticeable notch.

[2] It was unclear whether CSIS/NCRP mandated annuitization of their Individual Security Accounts or restricted pre-retirement withdrawals.

[3] The CSIS/NCRP proposal for a minimum benefit equal to the poverty level could also have been deceptively less expensive, since poverty levels may only increase with inflation. However, it appears that they did not take the easy (less expensive) choice. Their initial minimum benefit is wage-indexed after 2010. This implies that productivity gains in the economy will be shared with all retirees (at the point of their retirement), including low income ones. After retirement, their benefit would increase with just inflation, like other retirees' benefits.

by phasing the minimum benefit in over 40 years of work.[4] Thus, the more years worked, the greater the benefit. Under their proposal, the 60% of poverty benefit after 20 years of work would phase into 100% after 40 years of work. A low income person would have some disincentives to work (or report income or pay taxes) after 40 years of service, which could be reached by someone age 58. If the formula was 2 % times the number of years worked, the incentive to work would continue beyond 40 years of work. Someone with 50 years of work would then get 125% of poverty level. This approach may not increase costs much. If you want to preserve the 60% after 20 years of work, the formula could use 3% times the first 20 years worked. Under this formula, someone with 50 years of work would get 120% of the poverty level. The costs should not be much different.

Some will not receive the full poverty level benefit: In order to have incentives for working, some people (who cannot work the full 40 years) will not receive the 100% poverty benefit. Therefore, the NCRP proposal's benefit reductions will create some inadequate benefits for some people. The government may have to pay them public assistance, which means government may have to pay the costs anyway. Furthermore, without a full poverty benefit, a proposal may then have to mandate annuitization of the Individual Accounts.

No Minimum for 19 years of work or less: The NCRP proposal creates a large cliff at 20 years of work, below which, a worker would get no minimum benefit. Providing proportionately lower benefits for workers with less than 20 years of work should not cost much. The benefit would be inadequate of course, but so is the benefit after 21 years (equal to 62% of poverty level). We are unaware of any concern, abuse, or moral hazard that minimum benefits would cause for people with short work histories. Eliminating the 20-year requirement would be simpler, provide benefits proportional to years that contributions were made, and not have any cliff effect, which would primarily affect low-paid immigrants and women who care for children. In fact, lowering the 20-year requirement could create incentives for people with short work histories to work more.

Early Retirement Reductions: If the minimum poverty level benefit is not reduced by early retirement reduction factors (and increased by delayed retirement factors) just like other PIA benefits, there will be a strong incentive to retire when first eligible. If it is reduced, then the benefit payable before NRA will be less than the poverty level (e.g., it would be 30% less in 2029 when the NRA reaches 70 for someone retiring at age 65). If the minimum benefit was set at 150% of poverty levels at the NRA then the age 65 ERA benefit would be at least 100% of poverty level. The benefit could reach 150% at age 70, if the formula was 3% times years worked (e.g., 3% x 50 years of work = 150%).

Disability Benefit: Under the NCRP proposal, it is unclear whether an individual receiving the disability benefit would get the minimum. If yes, and if total income exceeded income while working, there would be little incentive for rehabilitation and returning to work. Current rules limit disability benefits so that total income is less than 80% of average earnings, and that could help allay this concern if applied here too.

Spouse Benefits: Should the dependent spouse of a worker receive the full poverty minimum? If yes, then the couple will receive more than the poverty level for a couple. If the spouse receives 33% of the poverty level, it will be closer to the poverty level for a couple. Also, we assume that the surviving spouse will also receive the minimum poverty benefit because very elderly single women have the highest poverty levels among the elderly.

Minimum could be a windfall: The minimum could provide an individual with a benefit that is larger than recent salary amounts for the person, and thus could encourage them to retire. Having a maximum equal to the worker's Highest 5 year salary average (or something similar to the disability maximum) would reduce this problem.

3. Can Americans be encouraged to work longer? (and how?)

Retirement policy is one way to affect American's retirement decisions. Here are some ideas:

Retirement Ages May Be Increasing: Recently, labor force participation rates (see charts) have increased, possibly due to (for example) a relaxation of the Social Security retirement earnings test.[5] This also shows that some people can work at age 70. In addition, 401(k) plans don't subsidize pensions at younger retirement ages, like traditional retirement plans. If 401(k) participants want to retire early, they

[4] This would need to be defined. It could be say 15% of the wage base. Once reached, some might stop working.

[5] Workers over 70 can now earn a wage and not have their Social Security benefit reduced.

have to suffer the full actuarial reduction. This may force many people to work longer in the future.

Delayed Retirement Ages or Reduced Benefits: The labor force charts also show that Americans used to work to later retirement ages. The average male worked to age 70 before Social Security and Medicare (inter alia) inadvertently encouraged them to retire earlier. With not only our life spans improving, but also our health improving,[6] it would be possible for most people to work longer. If Social Security, SSI, Medicare, and Medicaid delayed or reduced benefits at younger ages, people would be more likely to work longer in order to have a secure retirement. Eliminating benefits at younger ages would have an especially powerful effect. That's because many people may still take reduced benefits at younger ages even if they are not adequate.

Decrease Social Security Benefits: Proposals to decrease Social Security benefits may also encourage us to retire later. However, even though they are similar to proposals that increase the NRA, they may not register until too late. Most people don't know what their Social Security benefit amount is, so decreasing it won't affect their thinking now. Only when they reach age 65 will they realize how much the benefits dropped. At that point, they will finally realize that they have to work until a much later age. Thus, raising the retirement age could be the more effective way of making changes to Social Security. It is more likely to affect our thinking now than just decreasing benefits.

Relax or Eliminate Retirement Earnings Test: Another chart shows how Social Security has a clear and direct impact on people's decision to work. The chart shows that large numbers of older people work up to the retirement earnings test exempt amounts and then stop. This not only shows that Social Security affects our decisions, it also points to another way for Social Security to encourage us to work—by eliminating (or increasing) the retirement earnings test exempt amounts. Social Security actuaries estimate that this would not hurt the actuarial balance. However, it does increase cash outlays in the short term.

35-Year Average Earnings: Another way is to modify the benefit formula. Currently, many people commence benefits at age 62. That's because, even though there is a 20% penalty for early retirement, the Social Security PIA benefit is not improved much after a person has 35 years of work. Paying more contributions after 35 years of work does not improve the benefit much. This could be changed by determining average wages over say 40 years rather than 35 years (or NRA minus 20 minus 5 drop out years, which would automatically update it when NRA is changed). However, this change could hurt women who leave the workforce for children. This concern can be alleviated by allowing additional drop out years for taking care of children up to age 5 for example. The law already allows drop out years for women caring for children for some disability calculations.

Allow/Encourage increased retirement ages in Private Sector Pension Plans: The current Internal Revenue Code (IRC) still references age 65, 59, and 70 for various pension-related rules.[7] (A couple IRC rules reflect the new Social Security NRA, but not many.) These ages could be updated, to encourage employers to raise the ages in their pension plans. In addition, Congress changed the Social Security NRA without protecting prior benefit promises. If Congress gave employers some flexibility in this area, it might make it easier for employers to increase retirement ages in their pension plans. This should be changed only after careful study.

Provide some flexibility to employers to encourage hiring older workers: As I testified, older workers can cost more due to higher health costs, etc. If Congress added some flexibility to the Age Discrimination in Employment Act, so that total compensation costs for older employees did not have to increase, then employers might be more willing to hire and retain older workers. Rules making it easier to have phased-retirement would also help. For example, IRS regulations could be changed to allow in-service distributions to be payable before a pension plans's NRA[8] and partial Social Security benefits could be paid to reflect an older person's phased retirement.

4. How is the Congress sending mixed signals about its policies on retirement age and what issues are the most important for us to address to ensure consistency?

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[6] See Chronic disability trends in elderly US populations: 1982–1994 by Manton, Corder, & Stallard. In 1982, 14.1% of elderly between 65 and 74 were IADL (Instrumental Activities of Daily Living) or ADL impaired or institutionalized. In 1994 this decreased to 11.5%. For ages 75 to 84, it dropped from 31.9% to 26.9%.

[7] See the definition of Normal Retirement Age (65 & 5) in 411(a)(8), the maximum distribution age of 70 for owners in 401(a)(9), the anti-cutback rule in 411(d)(6), and the commencement rules (65 & 10) in 401(a)(14).

[8] IRS reg 1.401–1(b)(1)(i) requires that retirement plans be exclusively for retirement and other incidentals.

Social Security is moving its retirement age to 67, but Medicare is still 65. In addition, the federal laws for employer-sponsored pension plans still use age 65. (Note: If Congress amended pension law to use the same ages as Social Security, some companies might take advantage of it. This could be a revenue raiser for the government, because employer contributions could go down—or at least not go up.) Another inconsistent signal is the requirement that IRA's and some certain pension benefits begin their distributions by age 70 even if the individual wants to continue to work. Raising the 70 would defer government revenue however. You could also raise the 59 age for earliest distributions, but that could discourage people from putting money into IRAs and 401(k) plans, since it would lock the money up longer. It would also be a revenue loser for the government.

5. What do you see as possible options for indexing the retirement age and what are the advantages and disadvantages of each?

As provided in my written testimony, here are some choices.

Pay Benefits for the Same Number of Years. One way to index the NRA would be for Social Security to provide benefits for the same number of years (i.e., keep the life expectancy at NRA the same). When Social Security was created, life expectancies at 65 were about 12.7 years[9]. If we used this method, the NRA would be around age 72 today. It would have gone up 7 years in 6 decades. (This figure is cited to show what the effects would be if this had always been in law. If you change the law now, you would probably not go back to the 1930's, but start the change at a current or future date.)

Under this method, the ratio of workers to beneficiaries would continually go up and thus the costs of our unfunded system would generally decline under this suggestion. Similarly, in a funded system, the costs of buying the indexed annuity would remain the same. However, since it can now be funded over 7 more years (i.e., ages 65 to 72), the annual amount that needs to be saved would continually decrease.

Keep the ratio of years in retirement to the working lifetime the same. Another way to index the retirement age would be to determine the age that maintains the same ratio of retirement years to working years. This could be accomplished in several ways. One example would be to divide the life expectancy at NRA by the potential years worked (e.g., the years from age 20 to 65). This would be a compromise between freezing the NRA at 65 (which would dramatically increase costs) and freezing the life expectancy at NRA (which could dramatically decrease costs). In fact, it was recommended by a majority of the members of the 1983 National Commission on Social Security Reform. This idea could stabilize the costs of the system and it wouldn't go out of balance every year as another deficit year was added to the 75-year projection. If this idea had been used since the creation of Social Security, the NRA would be age 70 now. This is an easy calculation. However, it doesn't reflect whether our health is continuing to improve also. This could be handled by using a health index. For example, we could look at the disablement rates (or some sort of health index) at the NRA and prohibit an increase if the rates (or index) were getting worse. However, this has problems. A health index could be quite subjective and it could trap us into setting different Retirement Ages for men and women, and for different worker classifications, minorities, or income levels. Multiple retirement ages and provisions are some of the reasons the Chilean and other foreign systems were collapsing, so we may not want to open that Pandora's box.

Maintain Same Cost Levels: Another method would be to use the calculation of the NRA to maintain a level cost for the system. Other similar methods would be to maintain the same dependency ratio of workers to retirees. In a funded system, it would require an actuarial calculation to maintain the same contribution or savings rate for each person. However, these methods entail a much more difficult calculation, and it would depend on many different assumptions about the future. For example, it could mean that the NRA could go up even if we weren't living longer—for example, if fertility rates declined or if the economy got worse. That might not be appropriate. In fact, it might be more appropriate for those variables to affect the tax rates. For example, if national birth rates decline, then maybe we should contribute more, not raise the retirement age.[10]

[9] The Trustees' report uses composite life expectancies based solely on the death rates for the year in question. Actual life expectancies (with an assumed mortality improvement) for people living in that year might be more appropriate, especially in a funded system.

[10] Congress could index the system now, or wait until the problems occur. If they decided to index, there would need to be rules on how big the problem would have to be before change occurred, and how to phase it in gradually. Changes could be subject to an override by Congress and would need a cap on how much change could occur and how often a change could occur. There are many issues which would have to be worked out on this.

NRA changes in law or updated by Social Security's Actuaries: The law could specify the increase in the retirement age, as it does now. Currently, the law stops the increases at age 67. If, as expected, we continuing living longer, the system will go out of balance again. A gradual increase in the retirement age would keep the system in balance (which keeps the trust fund stable in the out years). Thus, some proposals increase the NRA by 1 month every 2 years. Other proposals increase it by as much as 2 months every year. One can use different periods in the past (or in projections) to support either of these indexing proposals (or something in between).

An alternative, would be to set the increase in law, but allow the Social Security Actuaries to adjust it if and when life spans change faster or slower than expected (within constraints set by Congress and subject to their override). This would help Congress avoid reopening the difficult debate on how to fix Social Security every 20 years or so. However, some people might contend that it is not appropriate for a non-elected individual (Social Security's Chief Actuary) or agency to adjust something this important. (However, it should be noted that BLS economists can affect the COLA amounts, and Canada has invested similar powers in its government actuary.) Another concern is that people like to know their NRA in advance. A response would be that Congress could set constraints on the adjustments, so that no one over age 55 would be affected.

6. I'm interested in knowing your views on the degree to which age discrimination may ultimately prevent increased participation of older workers in the work force.

An SSA publication by John Straka, The Demand for Older Workers, asserts that employers that limit the number of older workers (or reduce their earnings) do so for productivity and market efficiency reasons and not for prejudicial discriminatory reasons. He bases this on his theory that (ultimately) in an efficient market, people are paid what they are worth. He also says that job opportunities for older workers will be mostly confined to relatively low-paying, labor-hungry sectors and occupations such as certain retail and clerical work and part-time or temporary work (e.g., on holidays). These jobs may not be attractive to many elderly workers who once had well-paying jobs. His position is that the Age Discrimination in Employment Act (ADEA), shortages of younger workers, and SSA policies to encourage work will not be adequate to both get jobs for the elderly and safe-guard their well-being. He suggests more subsidized training and resources for older job searchers.

My expertise in this area is limited, so I will just discuss those areas with which I am familiar. In my testimony I noted that in 10 years, employers may need more workers due to the start of the retirement of the baby boomer generation. (See chart showing declines in Increase in Labor Force.) This may already be happening. Unemployment levels are decreasing dramatically, and this could encourage the retention and hiring of older workers. Anecdotal evidence is that many older workers that were laid off in the early 90's have been rehired (at least on a part-time basis).

However, it is still true that the employee benefits of older workers can cost more [11] than for a younger employee. Unless employers can offset this higher cost somewhere else, they may prefer hiring anyone else that is cheaper (e.g., younger workers, aliens, part-time older workers who don't have to get employee benefits, etc.). Thus, ironically, Congress could decrease discrimination by relaxing the Age Discrimination in Employment Act to allow, for example, employers to offset salary increases by increases in an employees health costs.

7. Will there be enough jobs for older workers, jobs with the level of physical activity that most persons over age 67 can perform?

The issue of whether there will be enough jobs ultimately depends on the nation's economy/productivity. However, as discussed above, the retirement of the baby boomers (see chart) should dramatically increase job opportunities in the first 30 years of the next century. However, the question for older workers is not whether the jobs are there, but whether they will get them. If as discussed in #6 above, it is not efficient for an employer to hire the older worker, then the older worker could lose out to younger workers, aliens, etc. Whether older workers will be able to perform the jobs of the future is better discussed by gerontologists, futurists, and others. Many will be, especially now that our economy has more service-oriented jobs than physically-arduous ones, especially if an older worker's knowledge is valued. However, older blue collar workers will have to be trained for the less physically demanding jobs. In addition, your decisions now on the NRA will apply in future years, long after the baby boom retires. Whether there will be enough jobs then, is difficult to predict.

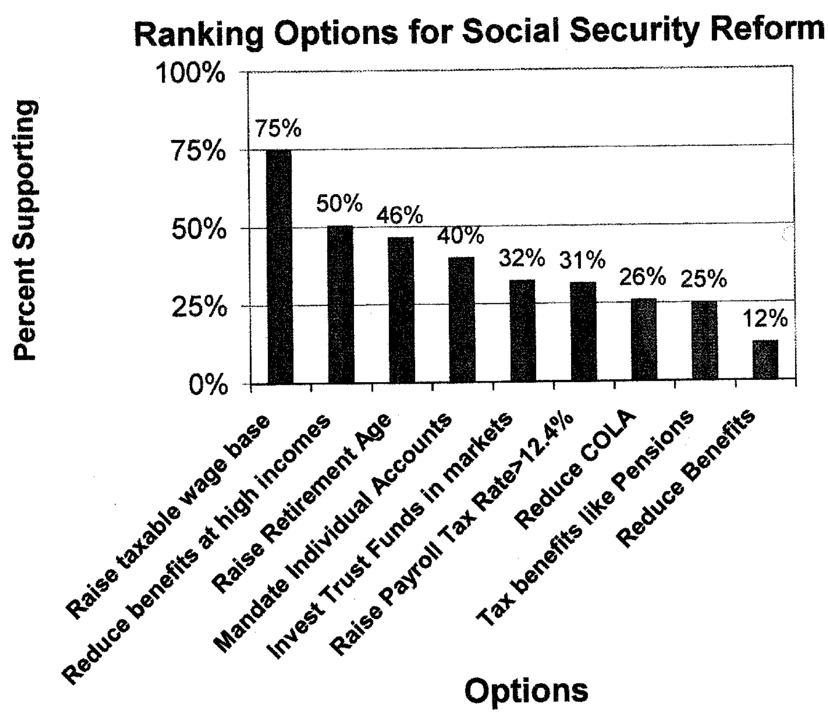
[11] Especially health costs, although the existence of a post-retirement health plan or unreduced pension plan benefit can offset this higher active employer health cost.

8. Do you have thoughts on how the increasing number of older workers might impact rates of unemployment, job opportunities, and career advancement for younger workers?

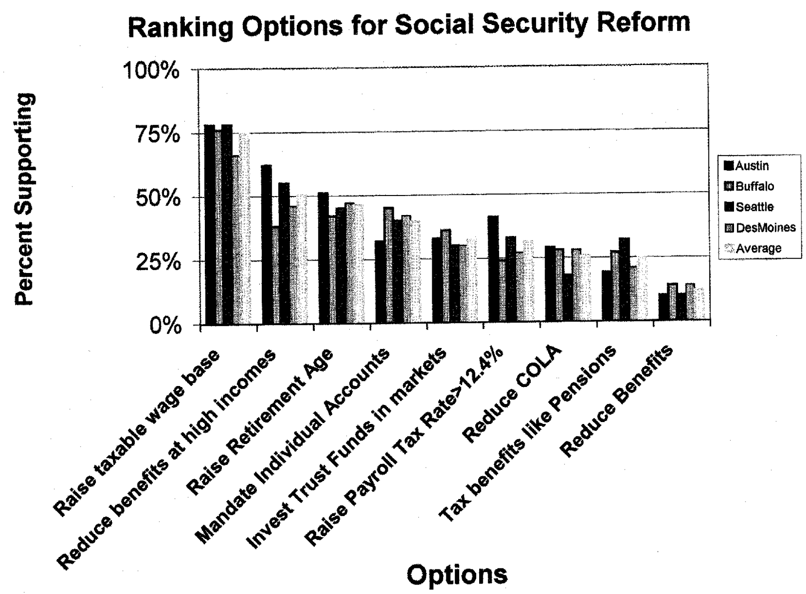
The issues you note in these last 3 questions are all very important and call for the expertise of many professionals in addition to actuaries. Raising the retirement age and encouraging people to work longer can increase unemployment and reduce job opportunities and advancement for younger workers.

However, the aforementioned graph of increases in labor force shows it is now lower than in any time on the graph (and soon will be less than the increases in the total population for the first time since 1960). Thus, you could increase the NRA and still keep the labor force increase below the increase in the population. In fact, you might ask the Social Security actuaries to revise this forecast based on various proposed changes to Social Security.

We want to thank you again for holding the hearing and inviting us to testify. We are more than happy to answer further questions or meet with you to discuss these and other items at any time.

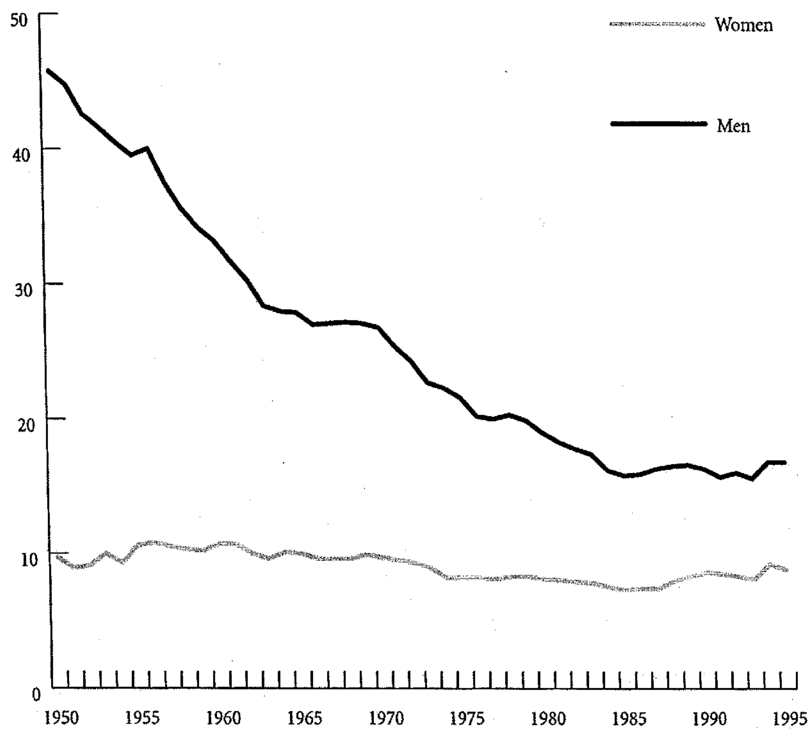


Source: Americans Discuss Social Security forums across country, sponsored by Pew Charitable Trusts.



Source: Americans Discuss Social Security forums across country, sponsored by Pew Charitable Trusts

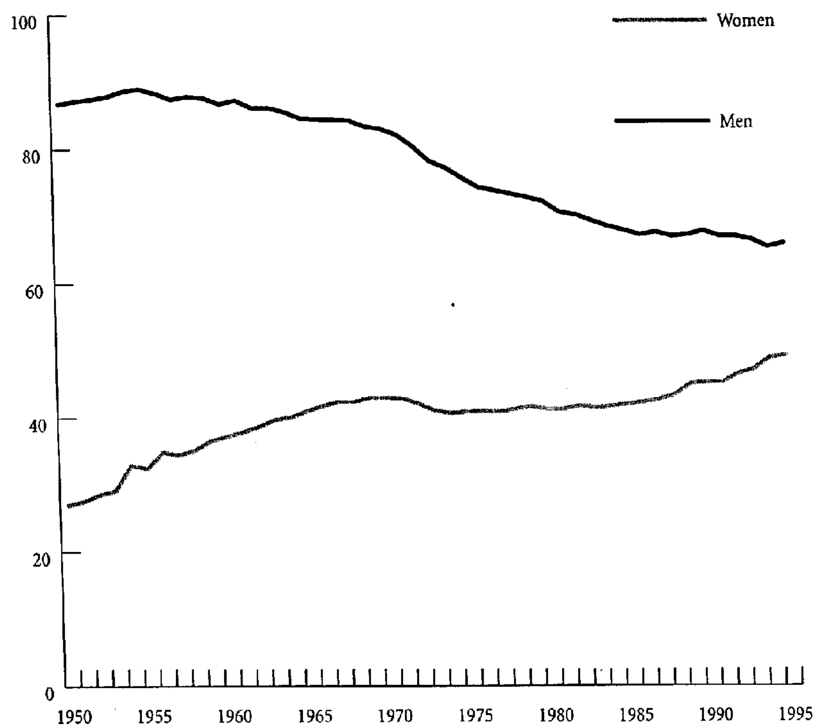
Labor Force Participation Rates of Men and Women Aged 65 and Older, 1950 to 1996



Source: Labor Force Statistics from the Current Population Survey, Bureau of Labor Statistics Web site (stats.bls.gov), Series ID: lfs604901, seasonally adjusted.

Social Security, Medicare, more employer-provided pensions, and post-retirement health care encouraged earlier retirement. After 1985, the trends in participation rates turned around. Possible reasons for increased labor force participation could be: improved economy creating greater demand for labor, relatively smaller cohorts of new workers replacing larger cohorts of new retirees, better health and greater desire for work at older ages, less availability of post-retirement health care causing people to wait until age 65 for Medicare, and pro-work rules (e.g., prohibition of age discrimination through ADEA and disability discrimination through ADA, OBRA 86 amended ADEA to eliminate mandatory retirement at any age, and ERISA to require pension accruals at older ages; Social Security earnings test increased, and eliminated over age 70; smaller reductions to Social Security benefits for wages above the exempt amount, increased delayed retirement credits increased Normal Retirement Age – the last 2 were effective long after 1985, direct job creation, and training programs through the Older Americans Act.)

Labor Force Participation Rates of Men and Women Aged 55 to 64, 1950–1996



Source: Labor Force Statistics from the Current Population Survey, Bureau of Labor Statistics Web site (stats.bls.gov), Series ID: lfs604901, seasonally adjusted.

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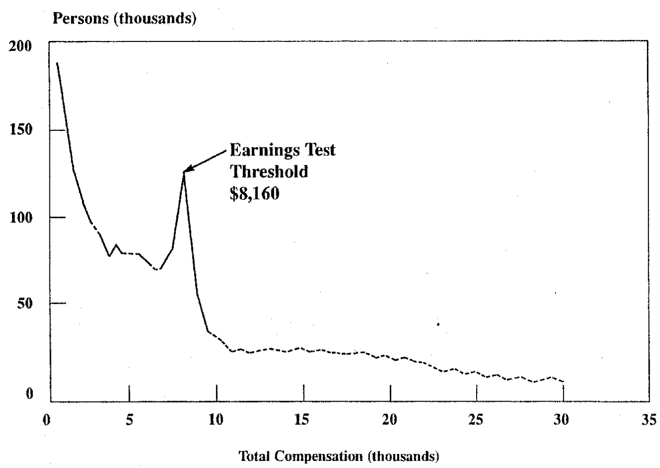
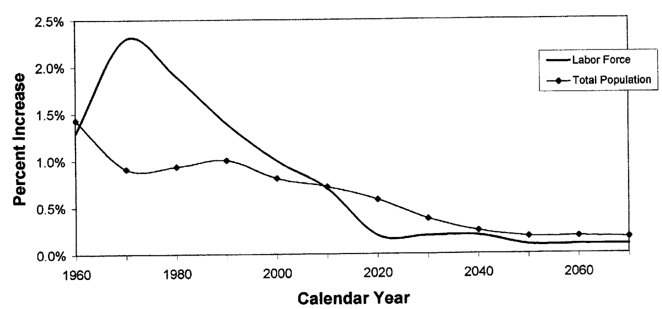
Figure II-7

1988 Retiree Earnings Patterns, OASI Beneficiaries and Fully Insured Nonbeneficiary Workers, Aged 65–69



Source: Continuous Work History Sample
Leoneslo (1991)

Average Annual Increases in Labor Force and Population



Data Source: 1997 SSA Trustees Report, pages 60, 124, & 148.
Note: Due to smaller increases in labor force, employers may stop encouraging employees to retire. Unemployment will decrease.

Chairman BUNNING. The final panel today is Christopher Bone, the chief actuary of the Actuarial Sciences Associates. David Walker is a partner and global managing director with the international accounting and consulting firm of Arthur Andersen, and David Smith is the director of the AFL–CIO Public Policy Department.

Mr. Bone, would you please begin?

STATEMENT OF CHRISTOPHER M. BONE, CHIEF ACTUARY, ACTUARIAL SCIENCES ASSOCIATES, AT&T, SOMERSET, NEW JERSEY

Mr. BONE. Mr. Chairman, Members of the Subcommittee, thank you for your invitation to appear. In your opening remarks and in the last panel, we heard about the important of coordination of Social Security changes with other plans. We welcome the Subcommittee's emphasis on Social Security as part of an integrated U.S. retirement income system.

Numerous observers have called for Congress to act soon on changes to Social Security to enable workers sufficient time to plan for retirement. An integral part of the planning process will be undertaken not solely by workers, but by employers that sponsor retirement plans. In choosing amongst alternative reforms in the near future, it is imperative that the Subcommittee consider the role of voluntary, employer-sponsored retirement plans and the impact of Social Security reform on those plans. Failure to do may result in significant disruption to the private retirement system, and the possible loss of valuable retirement benefits to millions of workers.

I'll focus the remainder of this discussion on employer reactions and issues around raising the Social Security retirement age. First, none of the proposals that would change the retirement age would do so sufficiently to cure Social Security's ills singlehandedly. Thus, in evaluating any proposals to raise retirement age, and their impact on the system, it's important to evaluate them as part of a package and to review the alternative reforms that could be paired with these types of changes.

Employers' responses to Social Security changes will be made in the context of, at least as far as designing retirement systems, the changes to the retirement plan that further their business and work force goals. As we saw in the last session, as labor markets change, it is to be anticipated that employers will react to those changes in the labor force and design plans that are tailored to attract and retain employees at those ages.

To look at how a change in this proposal would affect the private retirement system would require you to look at how different types of current plans would be affected and how those changes would change the employer's ability to meet business objects. Thus, if we see changes in the demographics, we can anticipate that employers will react to those changes in the demographics at the same time, or perhaps at a later point, than public policy reacts to them under Social Security.

The specifics of how employers are likely to react is work that is yet undone. Employers are interested in the different alternatives. Researchers are interested. One way to look at this is to say, what would cause a disruption in the private sector system? Disruptions are likely to occur if the amount and incidence of the cost to the sponsor changes significantly or if there is a sudden and sharp change in the behavior of plan participants.

To the extent that proposals to increase Social Security retirement age are based on an accurate scenario of the future that reflects the availability of a productive work force, employers will respond to the same trends by raising retirement ages in tandem with Social Security. If changes in the retirement age reflect changes in labor pools, changes may be anticipated to have relatively small effects in terms of disruption to the current retirement plans.

There do exist a group of plans for which changes in the Social Security normal retirement age could be anticipated to be disruptive currently. These plans provide benefits that bridge the gap between actual retirement and commencement of Social Security benefits. Any increase in the Social Security normal retirement age that is sudden would create a cost to sponsors who would then have to bridge these benefits for a longer period of time; however, the cost to these types of plans to be made manageable through appropriate delay in the commencement date of any change in retirement eligibility.

The existence of a sufficiently long planning horizon can enable these plans to adapt the general level of benefits to the changed circumstances. It's important to note that we have experience with similar changes under the 1983 Social Security reforms. The long duration before changes in the normal retirement age were effective gave employers the opportunity to adjust pension plans to the changes.

Changes in the normal retirement age do not appear to abruptly increase cost for employer plans, nor to unduly change the system. Much more significant were the related changes of the Tax Reform Act of 1986. In considering any changes to Social Security retirement ages, legislators may wish to consider the experience of the 1983 changes and provide similar timeframes for employer-responsive plans.

In addition to sharp disruption in costs, the employers are also concerned with sharp changes in employee reactions, in particular whether or not an employee perceives that he/she will be subject to a sudden prolonged delay in in the ability to retire.

I think that we have issues of worker productivity. The key issue here for employers may be changes in retirement rules to give employees the same sort of flexibility to make productive arrangements for employees in the future.

Finally, I'd like to point out that in terms of disruption to the system, changes in Social Security normal retirement age are much less disruptive to the system of employee provided benefits than are certain other proposed changes, including changes in tax rates and in payroll benefits.

Thank you.

[The prepared statement follows:]

Statement of Christopher M. Bone, Chief Actuary, Actuarial Sciences Associates, AT&T, Somerset, New Jersey

Mr. Chairman, members of the Subcommittee, my name is Christopher M. Bone. I am the Chief Actuary of Actuarial Sciences Associates (ASA), a benefits consulting firm that is a wholly owned subsidiary of AT&T. I am speaking today on behalf of ASA.

INTRODUCTION

The retirement income system in the United States has often been pictured as a three-legged stool; the three supports of the stools being Social Security, employer-sponsored retirement plans and individual savings. In this analogy, significant changes in the length or strength of one leg of the stool may be anticipated to require changes in the other legs. Yet, to date, analyses of proposed social security reforms have primarily focused on the effects of the proposed changes on the Social Security program as a stand-alone entity. In designing effective and coherent retirement policy it is imperative that changes proposed for social security be reviewed in light of the implications of social security reform for the second leg of the stool—retirement plans sponsored by employers.

Numerous observers have called for Congress to act soon on changes to Social Security, to enable workers sufficient time to plan for retirement under the new rules. An integral part of the planning process will be undertaken not solely by workers, but by employers that sponsor retirement plans. In choosing amongst alternative reforms in the near future, I urge that the Subcommittee consider the role of voluntary, employer-sponsored retirement plans and the impact of Social Security reform on those plans. Failure to do so may result in significant disruption to the private retirement system and the possible loss of valuable retirement benefits to millions of workers.

Since the enactment of ERISA in 1974, the percentage of the elderly population receiving pension and annuity income has risen from 24% to 36%.[1] Furthermore, because of the inherent long time horizons of pension plans, these numbers significantly understate the anticipated rates of participation in the voluntary employer based retirement system that have come about in the last 20 years; various studies have put the projected rate of pension recipiency among the elderly as high as 77% to 81% by the time period 2018 to 2030.[2]

How Can We Anticipate Responses of Employers and Employer-Sponsored Plans to Increases in the Social Security Normal Retirement Age?

Today's hearing focuses on proposals to improve the solvency of the Social Security system by raising the age at which unreduced social security retirement benefits are paid. Various proposals would:

- increase Social Security Normal Retirement Age to age 70
- tie increases in the Social Security Normal Retirement Age to increases in life expectancy,
- change the age at which Social Security early retirement benefits are first paid.

None of the proposals to date would change retirement ages sufficiently to cure Social Security's ills single-handedly. Thus, in evaluating proposals to raise retirement age it is important to also evaluate the other alternative reform proposals that could be paired with this change.

Employers' responses to Social Security changes will be made in the context of designing retirement plans to further business and workforce goals. To anticipate how employers would react to potential changes, any change in Social Security Retirement Ages must be analyzed to determine how the change would affect each of the various current types of employer-sponsored plan designs. More specifically, the analysis must review how the proposed change might disrupt the ability of that design to meet its business objective; whether the objective be related to cash flow, financial statement impact or human resource goals. This is work which has, as yet, only begun to be performed by employers and researchers. At this point it is difficult to see, with any degree of clarity, the exact form that responses to Social Security changes would take. However, one framework for evaluating likely changes by employers is to review potential Social Security reforms in light of:

- the amount and incidence of the related cost to the sponsor of the plan, and
- the effect of changes on the behavior of plan participants.[3]

Amount and Incidence of Employer Cost. Increases in the age of retirement decrease the underlying cost of employer-sponsored pension plans in much the same way as they do for Social Security. However, in addition to underlying cost, the incidence of reported cost for financial statements is also of concern. Most plans for employees, regardless of sector of employment, feature an accumulation of capital or of retirement benefits. Reported employer cost is typically a function of the accumulation of benefits per year of service. If the date of benefit commencement is delayed, accumulation continues for a longer period and payout of benefits is over a shorter duration. This allows the sponsor to provide the same level of annual retirement in-

[1] EBRI Databook on Employee Benefits, 4th Edition, 1997, p. 60, Table 7.4 based on EBRI Tabulations of March, 1975 and March 1996 Current Population Surveys

[2] EBRI Databook on Employee Benefits, 4th Edition, 1997, p. 57, Table 7.1 citing 1991 Advisory Council on Social Security, Future Financial Resources of the Elderly and Lewin–VHI, Inc., Aging Baby Boomers, How Secure is Their Economic Future?

[3] Bone, Christopher M., "Actuarial Perspectives on Implications of Social Security Reform for Employer Sponsored Pension Plans", Pension Research Council Working Paper 97–16, October 1997.

come with a lower annual outlay of cost. Thus, in an employer's plan, delayed retirement usually reduces the employer's annual benefit cost.

However the retirement age for social security benefits is not necessarily closely linked to retirement age for the employer's plan; instead, employers typically design retirement plans to reflect employer perceptions of workforce needs. To the extent that proposals to increase social security retirement age are based on an accurate scenario of the future that reflects the availability of an active, productive older workforce, employers may be expected to respond to the same trends in worker productivity by raising pension plan retirement ages in tandem with social security. This would generally lead to slow reductions in benefit costs over time. But, to date, employers continue to sponsor early retirement incentives in defined benefit plans that encourage retirement well before the age of earliest retirement under social security, even as increases in Social Security Normal Retirement Age are scheduled to begin under existing law. Thus for these plans, changes in Social Security Normal Retirement Age might be anticipated to have relatively small current effect.

There exist a group of plans for which changes in the Social Security Normal Retirement Age can be anticipated to initially increase costs. These plans current provide benefits that "bridge" the gap between actual retirement and commencement of social security benefits. Any increase in the Social Security Normal Retirement Age would create a cost to sponsors who would then have to bridge these benefits for a longer period of time. However, the cost to these types of plans can be made manageable through appropriate delay in the commencement date of any change in retirement eligibility under Social Security. The existence of a sufficiently long planning horizon may enable these plans to adapt general levels of benefits to the changed circumstances. Alternatively, Congress could avoid disrupting the private sector system by directly coordinating legislation to increase Social Security retirement ages with legislation that would hold sponsors of these type plans harmless to increased benefits that are solely due to reductions in government-promised Social Security benefits.

Other employer-sponsored defined benefit plans integrate early retirement benefits very closely with social security through the provision of elective forms of benefit that bridge the gap until social security retirement age (either early or normal) is reached. For these type of plans cost issues are likely to be manageable. However, there will be increased complexity of administration unless action is taken to hold these plans harmless for changes that are designed to reflect the new Social Security changes.

It is important to note that we have experience with the cost effect of the 1983 Social Security reforms. The long duration before changes in the Social Security Normal Retirement Age were effective gave employers the opportunity to adjust pension plans to the changes. Legislative changes to conform the private pension plan rules to the new Social Security law changes were part of the Tax Reform Act of 1986, and employers were given an extended period to reflect the 1986 law. In fact, many other changes in the Tax Reform Act have been cited as onerous and costly, but the effects of the 1983 legislated changes in the Social Security Normal Retirement Age do not appear to have abruptly increased costs of employer plans. In considering any changes to Social Security Retirement Ages, legislators may wish to consider the experience of the 1983 law changes and provide similar time frames for employer-sponsored plans to adapt to changes in the law.

Changes in the Behavior of Plan Participants: If the Social Security Retirement Age is increased, an employee would be forced to retire at a later age to be able to sustain a consistent level of income. For an individual covered by both Social Security and an employer-provided pension, the delay would likely not be equal to the total increase in Social Security retirement age, as it would be mitigated by the compounding effect of increases in private pension accumulation. However, a delay or a reduction in Social Security benefits could certainly act to delay retirement somewhat, particularly for lower-paid employees that are relatively more dependent on Social Security. (Since the progressive determination of the Social Security benefit tends to provide relatively higher Social Security benefits for lower paid workers, motivation to accumulate other sources of retirement income is lower and reliance on Social Security benefits is higher.) For lower paid individuals in physically demanding jobs, there are concerns that, if the Social Security retirement age is increased for these individuals without a commensurate increase in productivity for workers nearing current Social Security retirement ages, employers may incur additional cost in providing retirement programs that maximize the productivity of the labor force.

Similarly, many employers continue to restructure their workforces as the nature and type of work required to compete in the economy changes. For employers that attempt to restructure primarily through voluntary early retirement offerings, increases in Social Security retirement ages are likely to lead to increased costs.

THE IMPORTANCE OF FLEXIBILITY FOR EMPLOYER PLANS AS WE FACE AN AGING POPULATION

Social Security is not alone in facing the issues of an aging population. For the country to be able to afford the retirement of the Baby Boom generation, either we must experience very significant increases in productivity for the younger part of the population, or employees must be able and employers must be free to enter into imaginative and flexible arrangements that allow employees to remain employed and productive to later ages. Current pension regulation provides an inflexible approach to the ability of employees to gradually reduce work hours with a career employer. Either an employee is active or retired. Instead of remaining productively employed with a career employer, employees now may migrate to a retirement employer, where it possible for the employee to reduce work hours without sacrificing pension entitlements. I urge the members to coordinate efforts on Social Security reform with efforts to increase the flexibility of private sector retirement programs. As an example, truly flexible retirement regulations could include changes to allow employees to partially retire with a current employer, reducing work hours while commencing a portion of the pension. Less traditional work arrangements will allow employers and employees to maintain productivity and reduce pressures on Social Security.

GAUGING THE EFFECT OF ALTERNATIVE PROPOSALS TO RAISE THE RETIREMENT AGE ON EMPLOYER SPONSORED PLANS

Proposals that increase Social Security Normal Retirement Age, either by indexing the age to life expectancy or by raising the age to a specified starting point, will affect employer plans in large part based on the amount of increase in normal retirement age and the amount of time that employers have to prepare before changes are required to be made to pension plans by pension regulations and the amount of time until actual increases in retirement age begin to apply to plan participants. The primary driver of employer cost is the amount of increase in normal retirement age from current law, whether the mechanism is through an indexed increase or to a fixed age. Employers are likely to find the uncertainty inherent in an indexed retirement age, and in how an indexed normal retirement age would interact with the complex pension rules, unattractive. The resulting uncertainty and lack of clarity in pension regulation may provide a yet another disincentive for the establishment of new employer-sponsored plans, but is unlikely to add enough cost to encourage employers to terminate plans.

Proposals to increase the age of first eligibility for Social Security benefits above age 62 have drawn much more concern. In particular, employers that are dependent on workers in physically demanding jobs are concerned that increased retirement demands not fall on the employer, if Social Security early retirement ages are increased. Increased pension costs for low-paying, physically-demanding work would generally increase the labor costs for low-skilled workers. This further reduces the ability of low-skilled workers to compete in the marketplace. Employers are also concerned over the potential for increased disability benefit costs if the age for early retirement under Social Security is increased.

GAUGING THE EFFECT OF INCREASING THE SOCIAL SECURITY RETIREMENT AGE VS. OTHER TYPES OF PROPOSED SOCIAL SECURITY REFORMS

While the effect of raising the retirement age on employer plans is difficult to specify, it may be useful to compare the effects we can see, with the projected effect of other Social Security reform proposals. Of course, the degree to which social security reforms determine changes in employer-sponsored retirement plans will depend on the regulatory environment for employer-sponsored plans and the desire of plan sponsors to use plans to affect retirement decisions of their own workforce. Preliminary analysis, based on the incidence of employer cost and the effect on employee behavior, indicates that phased-in changes in Social Security retirement ages may be much less disruptive to the private plan system than certain other types of reforms that have been proposed:

- Increases in social security tax rates would likely affect employer-sponsored defined contribution plans, due to the interaction of decreased ability to save by lower-paid individuals, with the nondiscrimination rules for defined contribution plans. Alternatively, Congress could act to simultaneously amend the non-discrimination rules to reflect anticipated effects of the increased tax rate on lower-paid individuals' ability to save.

• Removing the limit on earnings subject to payroll taxes would require immediate redesign of the majority of private sector, defined benefit plans and presumably some defined contribution plans as well if accompanied (as anticipated) by the elimination of permitted disparity rules at the time the cap on taxable earnings is removed. In conjunction with the progressive nature of the determination of the social security benefit, this could accelerate the trend to a two-tier system of unfunded pension plans for the top paid group, and a funded plan which is adequate for the lower paid and inadequate for employees in the middle.

• Proposals to change the investment policy pursued by the Social Security Administration, or to add IRA-type Social Security individual accounts will likely have effects not only on benefit design costs but also could change capital markets and financial cost drivers, particularly, for large private sector plans. The administrative implications of a switch to IRA type accounts could be extremely burdensome for the employer who might have to maintain Social Security records and balances for its employees, especially during periods of transition or portability of its employees from one employer or plan to another.

Thus, many of the alternative reforms have an immediate impact on private sector plans. On the other hand, increasing the Social Security Normal Retirement Age tends to have a delayed effect on many plan sponsors, giving employers the necessary time to implement adequate changes to their benefit structure. To reemphasize, looking back to 1983 when the Social Security Normal Retirement Age was increased to age 67, even while some legislation was incorporated in the Tax Reform Act of 1986, the ensuing changes did not have to be made immediately. This allowed the employers to group the change in the Social Security Normal Retirement Age together with the other long term demographic needs of their company, and gradually change the benefit structure to coincide with the changing demographics, without disrupting the benefit programs in place. Some employers are still today making changes to their benefit programs, to reflect the 1983 increases in the Social Security Normal Retirement Age.

CONCLUSIONS

The degree to which increasing the Social Security Normal Retirement Age determines changes in employer-sponsored retirement plans will depend on the regulatory environment governing these plans as well as the desire of plan sponsors to affect retirement decisions of their own workforce, to meet their human resources objectives. Changes in the regulatory environment for pension plans will be needed to reflect changes in retirement age. Additional changes in the pension regulatory environment are needed to help employers and employees enter into flexible arrangements to enhance employees' productivity as they age.

Increases in retirement ages are anticipated to have long-term design implications for sponsored plans; but these may be manageable with sufficiently long time horizons for plan sponsors to adapt to changes. Short-term cost increases may be limited to plans that provide early retirement supplements, or are restructuring. In comparison with several other types of proposed reforms, increases in retirement ages may prove less disruptive to private sector plans.

It is imperative that increases in the Social Security Normal Retirement Age be evaluated not solely for effects on social security benefits, but also with respect to effects on employer-sponsored retirement plans, and the desire and ability of employees to save on their own behalf.

Mr. Chairman and Members of the Subcommittee, I thank you for the opportunity to appear before you, and I would be glad to answer any questions you may have.

Chairman BUNNING. Thank you very much.

Mr. Walker, please.

STATEMENT OF DAVID M. WALKER, CPA, PARTNER, GLOBAL MANAGING DIRECTOR, ARTHUR ANDERSEN, LLP; AND MEMBER, BOARD OF DIRECTORS, ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS

Mr. WALKER. Thank you, Mr. Chairman. It's a pleasure to be here this morning. The hat that I have on today is I'm on the executive Committee of the board of the Association of Private Pension and Welfare Plans. Its members collectively represent about 100 million Americans covered by employee benefit programs.

For your benefit and the benefit of the other Subcommittee Members, I'm also a former Public Trustee of Social Security and Medicare, and currently serve with Senators Breaux and Gregg, as well as Congressmen Stenholm and Kolbe on the CSIS' National Commission for Retirement Policy, which is looking at reforming Social Security and the private pension system.

Mr. Chairman, what I'd like to do is to note that the APPWP has formed a board-level task force to look at the issue of Social Security. It's currently deliberating and has not finalized its deliberations. When we do, we would be happy to provide our recommendations. However, in the interim, certain preliminary observations with regard to Social Security reform and the possibility of raising the normal retirement age I think are in order, given the subject of this hearing.

First, APPWP believes that Social Security should be reformed in a comprehensive manner and on a reasonably timely basis—sooner rather than later—in order to minimize the disruptive effect, and provide adequate lead time for employers and individuals to adjust to the changes. We also believe that such reform needs to maintain the importance of the Social Security Program as a foundation of retirement security for current and future Americans. That's a very important element to a sound National retirement system.

We believe that increasing the normal retirement age, and possibly the early retirement age, should be seriously considered as a possible element of overall reform, given the fact that many have already recommended increasing normal retirement age—for example, the Committee for Economic Development. As was noted by my colleague, that would only have resulted in about 44 percent of savings that are necessary to put the program in actuarial balance over 75 years, but it is an important fact to consider, not only for financial reasons, but because of work force and labor force trends. The fact that in 1950 we had 16 people working for every person drawing Social Security; now it's down to 3.3 to 1, and by the year 2030, it will be less than 2 to 1.

In the final analysis, we need to analyze individual reform elements, including raising the normal retirement age or early retirement age, and other possible reform elements, to come up with a balanced program and to consider the interactive effects of those reform elements.

With regard to the specific possibility of raising the normal retirement age, several preliminary comments are appropriate. First, doing so would have significant implications not only on Social Security, but also on other government programs, such as the disability program, as well as other employer-sponsored programs, such as pension, health, disability, workers' compensation, and so forth.

These have to be properly analyzed and considered. It may result in individuals needing to work longer, either on a full-time or a part-time basis.

We believe that consideration should be given to looking at current laws that affect both government programs, as well as private sector pension plans, to possibly allowing additional flexibility for individuals who wish to retreat into retirement, rather than a cliff approach into retirement, where it's working full time on 1 day and not working at all the next. We think it's important, given projected labor force trends, that we look for more flexibility.

We also believe it's important to seriously consider eliminating the earnings test on Social Security, as a way to encourage people, but not require people to be productive longer in the work force, given projected skills gaps that we see ahead.

In addition, we believe that raising the normal retirement age would serve to increase the importance of private employer-sponsored retirement programs as an important supplement to the base Social Security Program. It is important to also consider ways that the private sector could be strengthened to increasing coverage; enhancing benefit security, benefit adequately, portability and preservation would be desirable.

And, last, but not least, Mr. Chairman, we believe that it would be extremely important that any change in the normal retirement age or early retirement age be phased-in over an appropriate period of time in order to allow time for individuals and employers to be able to adapt to that change, and frankly, as a matter of fundamental fairness.

Mr. Chairman, I would be happy to answer any questions you might have, and obviously, the APPWP and myself would be happy to contribute in any meaningful way that you deem appropriate in the future in this regard.

Thank you.

[The prepared statement follows:]

Statement of David M. Walker, CPA, Partner, Global Managing Director, Arthur Andersen, LLP; and Member, Board of Directors, Association of Private Pension and Welfare Plans

Mr. Chairman and members of the Committee, my name is David M. Walker. I am a Partner and Global Managing Director with the international accounting and consulting firm of Arthur Andersen LLP. My background includes serving as one of two Public Trustees of the Social Security and Medicare Trust Funds, as Assistant Secretary of Labor for Pension and Welfare Benefits and as head of the Pension Benefit Guaranty Corporation (PBGC). I am also the author of a book entitled: *Retirement Security: Understanding and Planning Your Financial Future*. In addition, I currently serve as a member of the National Retirement Policy Commission sponsored by the Center for Strategic and International Studies (CSIS).

I am appearing before you today on behalf of the Association of Private Pension and Welfare Plans (APPWP—"The Benefits Association"), an organization of which I serve as a member of the Board of Directors and the Executive Committee. As a result, my testimony today is designed to reflect the views of the APPWP rather than my personal views. The APPWP is the national trade association for companies and individuals concerned about federal legislation and regulations affecting all aspects of the employee benefits system. The APPWP's members represent the entire spectrum of the private employee benefits community and either sponsor directly, service or administer employee benefit plans covering more than 100 million Americans.

Today's subcommittee hearing is particularly focused on an examination of the implications of raising the retirement eligibilty age under the Social Security retirement income program (i.e., the Old Age Survivors Insurance (OASI) program). In my oral remarks today I will first outline certain information contained in the 1997 Annual Trustees' Report. I will then discuss some of the implications of increasing the Social Security normal retirement age on the private pension system and on retirement security in general.

CURRENT AND PROJECTED FINANCIAL CONDITION OF THE OASI PROGRAM

The Trustees of the Social Security and Medicare programs prepare an annual accounting of these programs for the Congress and the American public. This annual accounting is due by April 1 of each year. The 1997 Annual OASDI Trustees' Report ("the Annual Report") was issued in the spring of 1997 and covers the 1996 fiscal and calendar years. It also included a projection of the financial condition of the OASI program over the 75-year period ending in 2071. This long-range projection is important as a means to advise the Congress and the American people as to the likely condition of these programs in the years in which several generations can be expected to receive OASI program benefits. Specifically, a 75-year projection period is necessary in order to assess the likely financial condition of the OASI program for all individuals currently paying OASI payroll taxes, including new entrants into the workforce.

According to the Annual Report, the OASI Trust fund held approximately $514 billion in U.S. government securities as of December 31, 1996. In addition, the OASI program ran an approximate $56 billion surplus for the year then ended. While the 1998 Annual Report has yet to be issued, it is expected to show that OASI Trust fund assets totaled approximately $589 billion at December 31, 1997. It is also expected to show that the surplus for the year then ended amounted to approximately $75 billion. Importantly, under current law, all annual OASI program surpluses must be invested in certain U.S. government or agency securities. The current government bonds held in the OASI Trust Fund bear market rates of interest at their date of issue, carry maturities of up to 15 years and are not readily marketable.

According to the Annual Report, the OASI program met the Trustees short-term (10-year) test of financial solvency. The OASI program did not, however, meet the Trustees' long-range (75-year) test of financial solvency. The Annual Report also disclosed that the estimated 75-year financial imbalance in the OASI program amounted to approximately 1.84% of taxable payroll.

The Annual Report projected that, based on the Trustees' intermediate (best estimate) set of assumptions, the OASI Trust Fund would be exhausted in the year 2031. The projected exhaustion date is significant since, beginning in that year, the government will no longer be able to pay full OASI benefits on a timely basis. However, while the program would not be able to pay full benefits, the OASI program would still have a significant revenue stream for benefits and program expenses. Specifically, the OASI program is expected to have revenues equal to approximately 75% of projected benefit payments and administrative expenses during the period 2031–2071.

Given the above, OASI program revenues would have to be increased by 33% or benefit payments reduced by 25% beginning in 2031 in order to restore the financial integrity of the current program. Alternatively, more timely reforms would serve to lessen the degree of changes necessary to restore the financial integrity of the OASI program.

The projected OASI exhaustion date of 2031 may be a number of years away, however, history shows that it is likely to come sooner than projected. Specifically, after Congress enacted the 1983 Social Security reforms, the Trustees' projected that the OASI program would have adequate assets to pay full program benefits on a timely basis until about 2062. By 1991, the Trustees' projected exhaustion date had accelerated to 2045. As previously noted, the Annual Report projected the OASI Trust Fund will be exhausted in 2031. This is 31 years sooner than predicted in 1983 and 14 years sooner than projected in 1991. All of these projected dates are based on the Trustees' intermediate (best estimate) assumptions for the respective years. Unfortunately, history has generally shown that actual program experience is likely to fall between the Trustees' best estimate and high cost sets of assumptions. As a result, a further acceleration of the projected exhaustion date would not be surprising.

While the Annual Report noted that the OASI Trust Fund would be able to pay benefits on a timely basis until 2031, there is a much earlier fiscal challenge relating to the OASI program which needs to be addressed. Namely, based on the Annual Report, the OASI program is projected to enter a negative cash flow position in the year 2014, just two years after the first "baby boomer" is eligible for normal retirement. Beginning in that year, annual benefit payments and administrative expenses are expected to exceed payroll taxes and other revenues. In addition, the projected annual OASI deficits accelerate rapidly each year thereafter. For example, these annual OASI cash flow deficits are expected to grow to over $358 billion in the year 2025 alone.

Once the program begins to experience a negative cash flow position, the federal government will generally be required to take one of three steps in order to generate the necessary cash to pay OASI benefits and expenses on a timely basis. Specifically, beginning in 2014, the government will either have to increase OASI tax revenues, decrease OASI benefits/expenses, or revise the current nature of the government bonds held by the trust fund and sell them to willing third party investors. Obviously, the government could also take some combination of these actions in order to bring the OASI program into annual balance if it so chose.

Implications for Employer-Sponsored Retirement Plans

One way that total OASI benefit payments could be reduced is to increase the age at which normal retirement benefits are available. To date, the APPWP has not formulated a policy position with respect to the specific issue that you are examining with today's hearing. However, it should be recognized that changes in the eligibility age (both for normal retirement age and early retirement age) raise a number of important questions that extend beyond merely the impact on the fiscal integrity of the Social Security trust funds themselves. Such a change should be considered in the context of overall reform of the Social Security system along with its effect on the Medicare program, the labor force, employer-sponsored benefit programs and individuals. It is APPWP's position that the current Social Security program must be reformed in order to assure its long term financial integrity and sustainability. Such reform should be comprehensive in nature and enacted sooner, rather than later, to minimize the cost and disruption reform will have and to provide as much opportunity as possible to prepare for the changes inherent in reform.

Raising the Social Security retirement eligibility age will have very real implications for the employer-sponsored benefits system, both retirement and health related benefits. It is important that these implications be understood and analyzed.

Many retirement plan sponsors currently coordinate normal and early retirement eligibility under their plans with the Social Security eligibility age. In the past, employers have often used enhanced benefits under a private pension plan as a way of adjusting the level of a company's workforce without the necessity of layoffs. However, in the near future the United States is likely to experience a labor shortage, particularly among skilled workers. In this regard, potentially one of the greatest changes to the employer-sponsored retirement system that could be caused by increasing the Social Security eligibility age is a change in the retirement pattern of workers. The primary expected change would be that workers may remain in the workforce for longer tenures, either in the same position, or at a different job.

Another pattern that can be anticipated is an increased shift away from "traditional retirement" to "phased" or "partial retirement." Traditional retirement is when a worker totally exits the work force and commences distribution of his or her entire retirement benefit. A phased retirement is instead when a worker remains employed but at a reduced work schedule and earns reduced wages, but simultaneously receives a portion of his or her pension benefit. The combination of reduced wages and a distribution of a portion of the pension benefit results in the individual continuing to receive a similar or slightly reduced amount of income from combined sources. Raising the Social Security normal or early retirement age would reinforce the need to consider allowing additional flexibility under employer-sponsored retirement plans so that workers can begin receiving a portion of their retirement benefits before full retirement.

Certainly, continued employment on a part or full time basis would help meet the economic demand for skilled workers. However, some employers may want to continue to provide incentives for older workers to retire from their jobs to make room for younger employees. Plan sponsors who need this flexibility to recognize their workforce realities (i.e. recognizing the inability of some industries' workers to continue working) will face increased costs.

In addition, some individuals may need or want to retire earlier than the increased Social Security eligibility age. To the extent that employers do not supplement the difference in benefits there will be greater pressure on individuals who want, or need, to retire earlier to rely on individual sources of retirement security, including employer-sponsored plans. This would serve to increase the importance of assuring that federal laws and regulations are designed to encourage the creation, maintenance and proper funding of employer-sponsored retirement plans, including reasonable contribution and benefit limits.

Also, an increased Social Security eligibility age would likely result in greater use of employer-sponsored and government disability programs. There will likely be greater use of worker compensation and unemployment compensation programs. In addition, increasing the Social Security eligibility age may result in increases in the cost of employer-provided health plans. This would translate into greater costs for these programs due to longer coverage and greater use.

RECENT OASI PROGRAM REFORM RECOMMENDATIONS

A number of groups have recognized the projected financial imbalance associated with the OASI program. In fact, a number of groups have called for reform of the existing OASI program. Many of these organizations have made specific recommendations for consideration by the Congress and the Administration, including the increase in the normal Social Security eligibility age.

The most notable OASI reform group that has already made related recommendations is the 1994–1996 Advisory Council on Social Security (the "Council"). This statutorily mandated group issued its report in December 1996. While the Council agreed on the need to reform the OASI program, it did not fully agree on how to do it.

A majority of the Council members favor speeding up the current schedule for increasing the eligibility age for full retirement benefits under Social Security. Under current law, the eligibility age for full retirement benefits (currently 65) will gradually increase to age 66 for workers who attain age 62 in 2005. It will then remain at age 66 for eleven more years and then gradually increase to age 67 for workers who attain age 62 in 2022 or later. The majority of the Council members would speed up the schedule so that the age of eligibility for full benefits increases to age 67 by the year 2011. According to the Council's report, this change would save five percent of Social Security's long term actuarial deficit. After 2011, these same Council members would recommend a gradual increase in the eligibility age in the line with longevity trends.

FINDINGS OF THE COMMITTEE FOR ECONOMIC DEVELOPMENT

In its report issued one year ago this month, the Committee for Economic Development (CED) recommended a continuous two month per year rise in the normal retirement age beginning in the year 2000, until the age reaches 70 in year 2030. Further, the CED recommended that increases in the normal retirement age after 2030, should be linked (indexed) to changes in average life expectancy in a way that maintains a constant average ratio of working years to retirement years. This reduction would eliminate about 44 percent of the 75 year acturial deficit in the present program according to CED's report. The CED report noted that in the future an extended work life will be a necessity for most workers.

Among the members of the Committee's Subcommittee on Social Security Reform there was a disagreement as to whether the early retirement eligibility age should also be raised. According to the report, benefits at early retirement should be reduced actuarially to reflect the number of years of retirement before the normal retirement age. Those retiring at age 62 currently receive about 80 percent of the benefit at age 65. The present reduction along with maintaining the early retirement eligibility age will ensure that the penalty for early retirement at age 62 will rise as the normal retirement age increases. A large reduction in benefits would be intended to encourage individuals to work longer or to save more to finance their early retirement. At least some of the Subcommittee's members were of the view that the early retirement age should also be increased. This is because the availability of an actuarially reduced early benefit may serve as a trap for the unwary. More specifically, individuals may mistake the availability of an early retirement benefit as an indication that the benefit will be a sufficient safety net without understanding the full impact of the reduction on their total retirement income. If the early retirement age were increased, however, it would still be appropriate to consider facilitating full access to actuarially reduced benefits as early as age 62, but only for those individuals who retire because they are unable to work.

SUMMARY

The OASI program does not face an imminent financial crisis. However, the APPWP recognizes, and many believe, that we are beginning to experience an emerging crisis of confidence among the American public in connection with the Social Security and Medicare programs. This emerging crisis of confidence is primarily attributable to the growing concern regarding the financial integrity of these programs and the historical inability of the federal government to communicate candidly and deal effectively with the looming fiscal challenges facing these important federal programs. Many of these looming fiscal challenges are the result of known demographic trends.

Both the legislative and executive branches of the federal government have a responsibility to address this growing crisis of confidence. In addition, the private sector also has a responsibility to take steps to eliminate this emerging crisis of confidence.

While the OASI program does not face an imminent financial crisis, it does face a midterm financial challenge due in large part to known demographic trends. The most notable of these trends relates to the need to finance the significant OASI program obligations associated with the "baby boom generation" in the face of declining worker/retiree ratios. Specifically, we face rapidly accelerating OASI program obligations beginning in 2014. In addition, the worker/retiree ratio has declined from 16:1 in 1950 to 3.3:1 today. This ratio is projected to decline to less than 2:1 by 2030. Importantly, these demographic trends are a virtual certainty and the related implications on the financial condition of the OASI program must be addressed.

From a broader perspective, the challenges we face in connection with the OASI program are a subset of a much larger fiscal challenge. Specifically, according to estimates by the Concord Coalition, total mandatory federal spending (e.g., entitlements and interest on the federal debt) are expected to exceed projected federal revenues before 2020, if changes are not made. In addition, entitlements alone are expected to consume more than 100% of projected federal revenues by 2030, if reforms are not enacted. Social Security is a major part of these projected entitlement expenditures. Medicare and Medicaid represent other major dimensions of the growing entitlement challenge.

Fair and timely action is needed to restore the financial integrity of, and public confidence in, the OASI program. Fairness requires that any related program changes be balanced among different generations and that certain changes be phased-in to allow individuals time to adjust. Timely action is also appropriate since delay will only serve to increase both the severity and the difficulty of achieving the needed OASI program changes.

Achieving the needed OASI program reforms will require the development of nonpartisan policy options and the pursuit of bipartisan legislative action. Any successful reform package will also require a balancing of policy and political considerations. Importantly, Congressional legislative action will have to be preceded by a concerted national campaign to educate the American public as to the nature and extent of our challenges, various options, including raising the normal and early retirement eligibility ages, and their implications, and any recommended approaches to reform. These hearings, Mr. Chairman, are clearly an integral part of that national dialogue.

Finally, in pursuing reform of the OASI program, policymakers must recognize that any modification of the OASI program will also have a ripple effect on other important retirement income programs. Specifically, OASI program reforms will also necessitate congressional action designed to strengthen employer and union sponsored retirement income programs and individual retirement savings arrangements. Such actions should include, but not be limited to, efforts designed to rationalize existing retirement vehicles, review current plan sponsorship requirements, facilitate employee savings through payroll deduction, increase current contribution and benefit limits, strengthen existing minimum funding standards, eliminate inappropriate administrative burdens, enhance pension asset portability, improve the fairness of PBGC variable rate premium structure and encourage the preservation of pension savings for retirement income purposes.

Chairman BUNNING. Thank you, Mr. Walker.

Before I call on Mr. Smith, let me tell you, it took us 10 years to get the earnings limit moved from where it was at the $11,250 to $30,000 over a 7-year period. It cost $7 billion to get it done. We were trying to eliminate it, but it took 10 years and two administrations, and we finally got the second administration to sign onto the bill. So I want you to know that I'm for eliminating it completely, but, under PAY–GO, we have to find the money to do it.

Mr. Smith.

STATEMENT OF DAVID A. SMITH, DIRECTOR, PUBLIC POLICY DEPARTMENT, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS (AFL–CIO)

Mr. SMITH. Mr. Chairman, thank you. I know I'm the last witness in a long day, so I will try to as brief as my colleagues have set an exemplary example.

Let me try to respond to a couple of things that aren't in my prepared testimony, but that have come up today. One of them, and David mentioned it, as others have, is the labor market effects of raising the retirement age. Frankly, Mr. Chairman—and this may be unexpected coming from the AFL–CIO, but it seems to me that this a case where we ought to assume that the market will work. One of the questions—and I was talking with Chairman Greenspan earlier last year about—how do you explain what's happened to labor force participation really at both ends of the cohort. Older Americans coming back in, as we've testified, and among some young people who have stayed out of the labor force for most of the last decade and are finding their way back in. The answer here is simple: A very low unemployment rate, some pressure on labor markets, and employers figuring out ways to add men and women who weren't previously in the labor force.

They will do that with older Americans as well as they will continue to do it with younger Americans, and we won't want to assume that, in the absence of a tight labor market, raising the retirement, the normal retirement age, that that will happen, or that not raising the normal retirement age in the presence of a tight labor market won't yield precisely the same phenomenon we've seen over the last 3 or 4 years. Working people, men and women who have left the labor force, have been downsized or forced out, come back in when they have those opportunities. And I would expect that that will continue regardless of what we do with the normal retirement age, as long as labor markets stay tight. We ought to assume that the market, as you so often note, Mr. Chairman, is pretty thoughtful about these things, and this labor market will work in that way.

A second issue which gets raised here, which I really do want to emphasize—when I testified before this Subcommittee last spring, I said something to the effect that this system ought not to be thought of as a piece of the retirement system for Americans. This isn't a leg of a roughly balanced three-legged stool; this is the heart of retirement income for most Americans, and will grow in its importance over the next two decades, not diminish. Perhaps we would wish that not to be true, but it is true.

And it's especially true for Americans who worked in low-wage jobs, for Americans who have worked the nightshift, who've worked the dirty jobs, who've worked in the more dangerous jobs, and any increase in the normal retirement age, and particularly if it were twinned, as Dr. Myers had suggested, with a ratcheting up of the early retirement age, would have particularly serious effects on those Americans, people who have earned less in their lifetime and earned less probably in a circumstance where they will more likely to be exposed to health hazards, more likely to have been injured in a way, while perhaps not qualifying for disability—made it tougher for them at 62 than it did for some of the rest of us who had a chance to grow old somewhat more gracefully and less arduously.

A few numbers I think help illustrate that, both the reliance question and the vulnerability question. Now 46 percent of African-American older households rely on Social Security for 90 percent of their retirement income. That's a dramatically different figure than whites; only 28 percent of white Americans rely on Social Security for 90 percent of their retirement.

Twenty-eight percent of African-Americans 62 years or older, only 28 percent have any pension income whatsoever. When we're talking about opening up this hole for a group of people, we're not talking mostly about people in this room. We're talking about people who do very different jobs, are exposed to very different risks, and make a great deal less money.

Let me—one other: Precisely that same group of people, as you know, and as has been testified today, any increase in the retirement age is a benefit cut. It's widely understood that Social Security is actuarially sound. Were we to push the retirement age out, it would be a benefit cut for anybody. It would be a larger benefit cut for those who are more likely to die sooner. And African-Americans and other people of color are much more likely to die in that window, Mr. Chairman, than either you or I are. The death rate for males age 62 to 65 for African-Americans is 150 percent of the death rate for the white cohort during that same period.

So we're not talking, as some of the earliest testimony suggested, we're not talking about a generalized either circumstance with which we approach retirement or a generalized impact on us from these kinds of changes. We need to be very careful.

Thank you.

[The prepared statement follows:]

Statement of David A. Smith, Director, Public Policy Department, American Federation of Labor and Congress of Industrial Organizations (AFL–CIO)

Good Afternoon. Mr. Chairman and Members of the Subcommittee, my name is David Smith. I am Director of the AFL–CIO Public Policy Department. On behalf of our 13 million members and their almost 40 million family members, I am here today to express our great concern over proposals to increase Social Security's retirement ages and the very serious questions that they raise about fairness toward and protection of some of the most vulnerable members of American society.

BENEFIT CUTS THAT TARGET THE ECONOMICALLY VULNERABLE

Let me begin today by posing this question: Assuming in the first place that any Social Security benefit cutbacks are warranted, should it be done in a way that has the greatest negative impact on the group of workers who have spent their working years in physically arduous jobs, who experience poor health, who have the lowest levels of health insurance and pension coverage, and who have seen their real wages drop significantly over recent years? I hope it strikes you as unfair, if not mean spirited, to balance the long-range finances of the nation's principal family protection plan on the backs of those who need it the most. That, however, is just what an increase in the Normal Retirement Age would do.

Clearly, raising the full retirement age cuts benefits and does so in two significant ways. First, all workers, whether they delay retirement to the new full retirement age or continue to retire early, will get reduced lifetime benefits. Second, those who take early retirement will also receive lower monthly benefit amounts that provide a less adequate income throughout retirement. For example, under the current scheduled increase in the full retirement age, an individual who elects to begin receipt at age 62 will get a monthly benefit amount equal to 70 percent of the full retirement benefit, compared to 80 percent under the rules currently in effect. A further increase would cut this benefit even more. But this is not the whole story.

Keep in mind that for many retirement is not the beginning of a golden age cruise, but rather an economically traumatic event, especially for low-wage workers and people of color. With the cutbacks Congress enacted in 1983 beginning to take effect for early retirees in 2002, it may yet get worse. Consider that a fourth of African Americans 60 years of age and older live in poverty, compared to less than a tenth of White Americans. An overwhelming majority of these workers lack substantial sources of retirement income beyond Social Security.

- Forty-six percent of African American older households and 44 percent of Hispanic older households rely on Social Security for 90 percent or more of their income in retirement. And nearly a third count on it for all of their income.
- By contrast 28 percent of White retirees rely on it for 90 percent of their income and 14 percent of them count on Social Security for 100 percent.
- Only 28 percent of African Americans 62 years of age or older have any public or private pension income, compared to 43 percent of Whites of the same age.
- Furthermore, asset income, while more widely received than pension benefits, amounts to very little for most retirees regardless of race. For all of those 65 and older, the median is $1,306. Looking at the least well off quintile, the median annual asset income is a tiny $12 a month.

Also, it is critical to remember that any Social Security cutbacks will be sliced off of a baseline that is already quite low for the lower-income elderly. Among the poorest, the median Social Security benefit is roughly $5,500.

This background information feeds directly into discussions about raising the retirement age because an increase will hurt these already vulnerable populations the most. The benefit cuts imposed by an increase in the retirement age have a greater impact on those population subgroups whose members die younger, are forced to start benefit receipt earlier, and have few alternative resources to enable delayed receipt of Social Security or cover cuts in monthly benefit amounts. Those beneficiaries affected most are minorities, particularly African Americans, and all low-wage workers.

For workers who lack substantial alternative sources of income, any cut in Social Security is going to be more painful than it is for those who have other legs of the retirement stool on which they can rely. A worker who relies entirely on Social Security in retirement and retires at age 62 in 2022 and later will experience an additional 10 percent cut in benefits as a 10 percent cut in income. By contrast, an upper income worker who relies on Social Security for only one quarter of retirement income, as the top 20 percent of the elderly do, would see less than a 4 percent cut in total income from the same cut in early retirement benefits. The result will be even less adequate retirement incomes for workers and families already at the margin. The regressive nature of increases in the normal retirement age has been confirmed by one study that looked at the effects of an immediate increase in the Normal Retirement Age to 67. It concluded that the cut in benefits under a raised retirement age for incomes under $25,000 would be one and one-half times higher than for incomes above $75,000, measured as a share of lifetime income. (Wolff, Edward and Howard Chernick, "The Distributional Effects of Raising the Social Security Normal Retirement Age and Partially Indexing Benefits," EPI Working Paper No. 115, 1996.)

The argument that we should cut benefits by increasing the Normal Retirement Age is ultimately based on two related numbers: life expectancy and the percentage of the population in retirement. These are the same basic facts that Congress relied on in 1983 when it voted to increase the full retirement age to 67 in the next century. It would be a mistake, however, to treat life expectancy as a predictor of the health and well-being of the elderly and near-elderly populations. More importantly, a generalized treatment of these populations glosses over the very substantial heterogeneity that exists regarding life expectancy, health, job situation, and alternative economic resources. The most salient differentials exist between African Americans and White Americans, and poor/lower-income and non-poor workers.

African Americans as well as the poor and near-poor have shorter life expectancies than the population as a whole. The differences between White and African Americans is clearly illustrated in male mortality rates. While the magnitude of the mortality gap narrows among the elderly, a substantial difference persists. For example, the death rate from age 62 to age 65 for African-American men is over one and one-half times that of White men (8.9 percent versus 5.5 percent). An increased normal retirement age would disproportionately impact African American men simply because they are more likely to retire early. There is a 15 percentage point gap in the Labor Force Participation rates of White and African-American men ages 60 to 64. If early retirement ages were bumped up, a smaller percentage of age-62 African American men would survive to the higher eligibility age than White men. While separate life expectancy numbers are less well developed for poor versus non-poor Americans, the available evidence also suggests a substantial gap between the two groups. According to some estimates the mortality rates among the young elderly may be two times higher for the poor and near poor (the bottom 20 percent of income earners) than they are for the rest of the population.

While we do not know life expectancy by occupation, it is clear that people who spend their work lives scrubbing floors in a nursing home, moving 5 liter engine blocks around a factory floor, pouring steel into a Bessemer mill, or hauling bricks around a construction site can count on a shorter life span and a shorter work life. They are more likely to experience work place injuries and to lack the continued physical endurance necessary to perform their jobs very far into their 60's. We should not be telling them that they have to postpone retirement or do with less.

Much has been made of the issue of whether near and young elderly health is improving and will therefore enable longer working lives. While the evidence is far from clear, it is worth noting that health trends will likely be affected by health insurance coverage. The news on the employer-based health insurance front is not good. Eight million fewer Americans had employer-based coverage in 1996 than in 1989, and another 8.1 million can be expected to lose coverage between now and 2002. And the lack of employer-based coverage is felt most by low-wage workers: Whereas over 85 percent of Americans in families with $50,000 and more in income had coverage in 1996, less than half of those in families with $15,000–$19,999 in income did.

Of course, the response to our criticisms is that workers can simply make up the difference in benefits by accumulating greater savings and pension benefits to enable early retirement. However, it is difficult to argue that low- and even average-wage workers will be able to save more given recent wage trends. Between 1979 and 1995 the median wage earner saw real wages decline by 6.9 percent. And wage drops were greatest at the lowest wage levels: for workers at the tenth and twentieth percentiles real wages declined by 17 percent and 11 percent respectively. That is not a recipe for increased worker savings, as is evidenced by the decline in the personal savings rate from 7.4 percent to 4.7 percent (of disposable personal income) over that same period.

CONCLUSION

In conclusion, the most critical point in any discussion about Social Security's future is necessarily its historical and continuing role as *the* retirement system for average wage workers. Social Security, not pensions or savings, provides two-thirds of the elderly with 50 percent or more of their income in retirement. Despite retirement policy rhetoric about a three-legged stool of retirement income, for too many Americans Social Security is the only leg on which they can depend. Therefore, any changes to Social Security—while they may seem reasonable to people who will actually have three legs of retirement income—are potentially traumatic to large numbers of American families. Raising the Normal Retirement Age is clearly a change that would have harsh consequences for those workers that Social Security counts among its most important beneficiaries.

Disclosure Statement: Neither the AFL–CIO nor David A. Smith received funds from the relevant statute(s) during this fiscal or the preceding two fiscal years.

Chairman BUNNING. Let me also say to you that we are going to submit questions to you, individual questions on your testimony, but I want to ask Mr. Smith—if in fact we rule out any increase in retirement age, what are the other suggestions that you might have for stabilizing and making sure that we have solvency for all the boomers and those people past the year 2029, when, if we do nothing, we reduce it to 75 percent?

Mr. SMITH. Well, Mr. Chairman, as you know, we don't think doing nothing or hoping that it will——

Chairman BUNNING. I didn't say that. I'm looking for other suggestions.

Mr. SMITH. We could—and I'll make the suggestion that's least popular—we could raise taxes, either on us in a way to prefund the trust fund or on the cohort that will begin to retire, that will be working in about the middle of the decade, the second decade of the next century. There are a variety of other less traumatic things that we could do. I think there's a lot of imaginative work which can be done around the notion of part-time retirement. I'm not sure that I understand how all of those ideas would work, but it creates another option for older American, which seems to me to be sensible and would take some pressure off the trust fund.

I'll give the easiest answer here. We can continue to run the economy as well as we've been running it. The increase in the trust fund surplus at the end of 1997 was substantially higher than had been projected only a year early. It's very simple why that happened. More Americans were earning more money, and that's good for the trust fund. A few more years like this and we'll actually begin to see a material difference in the deficit that we have to make up.

We ought to close the gaps and ensure that this almost universal system becomes truly universal, and there are other suggestions made, some of the consensus suggestions out of the Grahamlich Commission which are well worth doing. I share some of Bob Myers' concerns about increasing the base, but I do think it might be done in a way that doesn't disadvantage women workers, and we ought to look at that.

Chairman BUNNING. Mr. Bone, in your statement you discuss the importance of sufficient long-range planning. In 1983, the long-range planning was the year 2000 all the way up for 20-some years after that, to increase every 2 months, or thereabouts, an increase in the age. If we plan to do anything, and all of a sudden we're past the year 2030 or 2035, how long a period are you talking about?

Mr. BONE. Well, I think there are two issues here. One is in the early retirement age, if you look in the Social Security Advisory Commission's Report, where one of the alternatives would tie early retirement age increases to increases in the normal retirement age, that's clearly too short for effective planning, because you would have that affecting people as they reach age 62 in the very near term future.

On the other, as far as inducing sudden cost changes to employer plans, which might require some offsetting changes, something that says moving the retirement age after age 66, for instance, as Mr. Myers had suggested, allows sufficient time for employers to begin to plan and for costs to be taken into account in redesigning plans, as the labor markets commence to change.

Chairman BUNNING. In other words, you're suggesting a 25- or 20-year——

Mr. BONE. I think that if you look at changes in the labor force and look at changes in normal retirement ages that are timed to occur around the time that we see significant reductions in the increase in labor force participation rates, that that's going to be more in tune with the changes that employers would naturally be making to plans, and therefore, less disruptive to the system.

Chairman BUNNING. Mr. Portman.

Mr. PORTMAN. I think it's great testimony; I wish everyone could hear it in the Congress. It's really very helpful. I have a bunch of questions. Let me just start with a couple of the premises with which we're working.

One is the notion, Mr. Bone, you talked about, and it was also mentioned by Mr. Walker, as to the growth of private pension plans. Seventy-seven percent of Americans by the year 2018 are expected to be covered by some kind of a pension plan, a retirement savings plan. Is that accurate?

Mr. BONE. That's a study cited in one of the EBRI data books, assuming reinvestment of lump-sum distributions; that over time—and once again if I can respond to some of the comments over here, I think it's very important to look at the generational effects of pensions as opposed to looking at current coverage by participants within different groups. As you look at changes in labor force participation by those groups, the effect as to whether or not they're covered by pensions changes dramatically.

Mr. PORTMAN. OK. I'm encouraged by that. It surprises me. Twenty percent of small businesses don't offer any kind of pension plan at all, and that's 25 or fewer employees. What we've been doing in Congress—Jim Bunning has been supporting this—is simplifying our pension programs. The President just made another proposal. The Simple Plan is doing well out there, and we're making some progress, but I would find it hard to believe that smaller employers would move that rapidly. It's great news. If that's true, we truly have a third leg, as Mr. Smith talked about earlier. At least one of the other two legs is pretty well established.

Mr. Walker.

Mr. WALKER. There are still significant coverage gaps, which are projected to continue, especially in the small business sector. We still only have about 50 percent of the full-time work force who's covered by private pension plans. In addition, the assumption in that study assumes that people reinvest lump sums, and the fact of the matter is that 70 percent of the people don't reinvest their lump sums. We're moving to a defined contribution system.

I think the bottom line is, while don't get me wrong, I'm a big believer in the private pension system; the organization that I represent believes that if you make changes in Social Security, especially raise the normal retirement age, you need to look at how you can expand coverage, how you can strengthen that system, provide additional flexibility and reduce burdens.

But I think the fact remains that if you look at income dispersion, that low-income individuals rely extensively on Social Security, and will continue to, as their primary form of retirement income. The facts are there.

Mr. SMITH. Mr. Walker said it all. The question here, Mr. Portman, is not, does somebody have a pension, but does that pension amount to very much? For a substantial plurality of us, it really doesn't. Coverage, pension coverage, in the private sector has slipped below 50 percent, and the trend is down, not up.

Mr. PORTMAN. I think one of the challenges we have as a Congress is to figure out ways to reverse that. I happen to believe that the legs of the stool are different, but they're all three very important, and you're not going to be able to back up Social Security unless you provide more pension alternatives, both defined benefit and defined contributions, and I think particularly in the area of defined contribution plans, we have a real opportunity with small businesses, and that will cover a lot more Americans.

So I do think there are three legs we need to focus on, and yet I'd be surprised if those numbers—and I guess the answer is really there will be more coverage, but it may not, depending on how the stock market goes. The coverage might not be adequate to provide for even a basic retirement, if someone were to retire or not have Social Security.

Mr. BONE. There are issues with the size of the benefit. I also, though, would like to point out that, looking at a snapshot of coverage at any point in time ignores the movement of employees in and out of jobs that are covered by pensions. So that, once again, there is an issue of the size of the pension, and that we need to increase accessibility of pension plans to a broader range of employers, but we do have a number of employees who move in and out of pension coverage and retain a right from it.

Mr. PORTMAN. OK.

Mr. Walker.

Mr. WALKER. I think you've raised an excellent point. The Commission that I'm working on, the CSIS National Retirement Policy Commission, is looking at all three elements of retirement income security: Social Security, private pensions, as well as individual savings. That's critical. You need to look at these things comprehensively because there is an interactive effect.

Mr. PORTMAN. And all related to the age issue?

Mr. WALKER. Well, they all are impacted by the age issue. I think we have to keep in mind the first social insurance system in the world was created by Otto von Bismarck in the 1870's. The normal retirement age under his program was 70; whereas the average life expectancy was 55. He had a great concept. He was going to take care of people and it wasn't going to cost much money. So there was a great politician for you. But times have changed and we've got to change with the times.

Mr. SMITH. Mr. Portman, you're absolutely right. The stool needs three legs to stand up and we need to pay attention to all of them. I would underscore what my testimony says about the centrality of Social Security, and two other numbers: The savings rate continues to trend down as a share of disposal income. So whatever meager contribution private savings now make, we should anticipate that for the next cohort of retirees it will be even less, and pension coverage—it's not simply the amount, although both my colleagues are right; the amount matters a great deal, but the reach of private pension is declining, unfortunately, has continued to even through these last half dozen relatively robust years in the economy.

Mr. PORTMAN. To make one final point, I had a broker in today to see me from a small town in Ohio, and he said two things. No. 1, the Simple Plan is very popular out there among small businesses. His company sold 15,000 of them last year. And second, there's this new Roth IRA. I hate when things are named after politicians, but this one actually happens to be successful, which is the third leg we talked about, and he says this thing is selling like hotcakes. I think that's good, because it's also in my view simplification because you don't worry about the IRS, once you make your contribution. I think there is hope out there, but I would hope that the AFL–CIO and our business partners can work with us on trying to make those other two legs work better as well to back stop it.

Thank you, Mr. Chairman.

Chairman BUNNING. Mr. Portman, I can't resist. Just be happy that the Simple Plan isn't called after a politician. [Laughter.]

[Questions were submitted by Chairman Bunning to Mr. Bone. The questions and responses follow:]

Question 1. You say that to date, employers continue to sponsor early retirement incentives in defined benefit plans that encourage retirement well before the early retirement age as defined by Social Security (age 62), even as increases in the normal retirement age are schedule to begin under current law. Is there anything in your view, that will change this employer practice? In other words, will a shrinking workforce require employers to take another look at these practices in the future?

1. Specific employers are likely to continue to sponsor early retirement incentive programs in defined benefit plans based on the particular needs of their business, need for employees and competitive environment. These programs satisfy a need for broad-based reductions in workforce size that are popular with both terminated and remaining employees and offer less negative effect on morale and marketplace perception than an alternative such as layoffs. As the population of workers entering the labor force begins to slow, I believe it likely that the number and frequency of these programs will decrease. In a marketplace that is increasingly competitive for employees, relatively more employers will find it easier to attain a desired workforce size reduction through attrition. Any downward changes in asset performance of pension plans would also serve to make the offering of these programs less attractive to employers. However, it is likely that some level of these programs will remain in place as specific employers adjust to the particular circumstances of their evolving competitive environment.

Question 2. You suggest that Congress should hold sponsors of plans harmless to increased benefits that are due solely to the reductions in government-promised Social Security plans. Would you provide more detail as to why this is important in your view and do you know whether Congress instituted any "hold harmless" provisions when they raised the retirement age in 1983?

2. Sudden changes in the system are the types of changes for which employers may need to be held harmless. (Employers could be held harmless by, for instance, granting them an exemption from the requirements of Internal Revenue Code Section 411(d)(6) when employers modify plans to reflect changes in Social Security benefit amounts.) The ability of employers to plan and adapt to changes in an unhurried and rational manner is important for many reasons:

- Plans of many large employers have benefits directly linked to Social Security benefits, retirement ages and/or the taxable wage base.
- Changes in Social Security will have broad implications on the availability of older workers.

To the extent that legislation directly impacts a plan's benefits employers need time to evaluate costs, redesign plans, retool administrative procedures, and communicate with employees. Pension plans are also a significant item in a company's balance sheet, financial statement, and its ability to borrow. To the extent that protected benefits are automatically increased as a result of links to Social Security, there could be a substantial impact on a company's financial health. The voluntary private sector system cannot absorb increases in costs due to unanticipated events without significantly affecting the desire of plan sponsors to maintain plans and provide retirement benefits to employees.

All companies, including those without plans that are directly linked to Social Security, need time to assess the broader demographic implications of legislation, not only on their benefits plans, but also on their overall business plan.

In 1983, by providing a sufficiently long-time horizon to reflect the emerging changes in Social Security, Congress effectively provided an opportunity for employers to:

- Adjust plans for future retirees through the ability to redesign the pattern of future benefit accruals
- Retain current plans for those near retirement without change.

Question 3. You discuss the importance of flexibility for employer plans to enhance employee's productivity as they age. Would you provide some examples for us on what you mean and how current law prevents this needed flexibility?

3. Retirement is more than just a financial decision. It is influenced by health, desire for leisure time, family considerations, the non-financial rewards of employment and many other factors. Current law makes it very difficult for employees to

partially retire with their current employer and receive both pension and a reduced wage in exchange for reduced hours. Employees desiring partial retirement generally change jobs. This results in lost productivity by both the employer and employee as training of replacement employees occurs at both the "old" and "new" jobs.

Current retirement plan law takes a "one size fits all" approach: you are either active or you are retired. Among the roadblocks to partial retirement are the following:

- Distributions from pension plans cannot commence prior to Normal Retirement Age unless an employee retires.
- Retirement distributions cannot be pro-rated to reflect part-time employment.
- Employment after Normal Retirement Age can require expensive benefit accruals and, unless confusing "suspension of benefit notices" are provided, actuarial increases.
- The legal definition of Normal Retirement Age itself, and many other rules that key off NRA have been unresponsive to the increase in Social Security Retirement Age, remaining at age 65 with five years of service.

Question 4. I'm interested in knowing your views on the degree to which age discrimination may ultimately prevent increased participation of older workers in the work force.

4. As the number of new entrants to the labor force decreases, and if the health status of older workers continues to improve, I personally believe that the employer's job requirements will adapt to the available workforce. Certainly, the country has seen periods in the past when labor force participation by older workers was much more common than it is today. This may reflect today's demographics which have a relatively larger number of qualified mid-career employees in the labor force today, rather than any acceleration of age discrimination in the recent past.

Question 5. Will there be enough jobs for older workers, jobs with the level of physical activity that most persons over age 67 can perform?

5. Projecting the number of jobs available for persons with the level of physical ability of most persons over age 67 requires a projection of both the level of future physical ability among older individuals and a projection of the relative amount of physical activity required in employment. Whether increases in longevity have been linked to improvements in physical well being of older individuals is the topic of active study. While neither a demographer nor an economist, my understanding is that recent studies do appear to show reductions in morbidity levels as well as in mortality rates. Levels of physical activity required to perform jobs would appear to be decreasing in the "information economy," but I am not aware of any reliable projections of future trends in required physical activity.

Question 6. Do you have thoughts on how the increasing number of older workers might impact rates of unemployment, job opportunities, and career advancement for younger workers?

6. This is an interesting area of exploration and modeling, but outside my own area of expertise. In addressing these questions, it will be imperative to link demographic studies with economic models. A discussion of these and related issues is contained in the National Research Council Report, *Assessing Policies for Retirement Income, Needs for Data, Research, and Models*, Constance F. Citro and Eric A. Hanushek, editors, National Academy Press, 1997.

Chairman BUNNING. Thank you all for your testimony, and we will stand adjourned.

[Whereupon, at 3:01 p.m., the hearing was adjourned subject to the call of the Chair.]

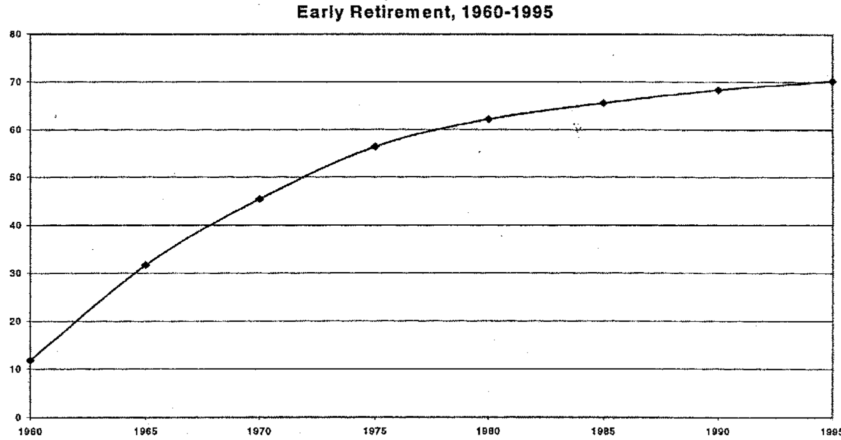
[Submissions for the record follow:]

Statement of Employee Benefit Research Institute, Kelly Olsen

Analysis using the EBRI–SSASIM2 Policy Simulation Model has shown that increasing the normal retirement age to 67 by the year 2011 and indexing it to longevity thereafter would save the Old-Age and Survivor's Insurance (OASI) program a projected 5.3 percent in total costs[1] over 75 years and 13.56 percent in annual costs in 2070.[2] In light of such positive financial implications, policymakers face the question of how a raise in the normal retirement age would affect beneficiaries. Issues include whether increasing the normal retirement age would be an effective means of achieving the desired policy goals, from what perspectives such a reform can be viewed by policymakers and the public, and the extent to which such an increase would disadvantage workers in physically demanding occupations.

In making these decisions, policymakers will likely find the following three points of interest. First, few persons today actually wait to retire at Social Security's normal retirement age. Since 1960, the percentage of Social Security beneficiaries with a reduction in benefits for early retirement has grown from 11.8 percent to 71.1 percent (chart 1). In addition, Employee Benefit Research Institute tabulations of data since 1988 have shown an increasing percentage of early retirees among those ages 55–64 (EBRI, 1997). In 1988, for example, 10.4 percent of the population ages 55–62 were retired, compared with 12.5 percent in 1996. In 1988, 32 percent of the population ages 63–64 was retired, compared with 36.5 percent in 1996, the last date for which data are available. These data suggest that if the goal of raising the normal retirement age is to encourage delayed retirement by raising the "age hurdle," the more significant hurdle in reality for most workers is the early retirement age.

Chart 1: Percent of Social Security Beneficiaries with Benefit Reductions for Early Retirement, 1960-1995



Source: U.S. Social Security Administration, Social Security Bulletin Annual Statistical Supplement 1997 (Washington, DC: U.S. Government Printing Office, 1997).

Second, an increase in the normal retirement age can, and has often been, viewed as a benefit decrease. However, since 1960, remaining life expectancy at age 65 has increased almost 21.7 7 percent, giving the average American an extra 3.1 years in later life (table 1). Had the Social Security retirement ages been indexed to longevity since 1960, the normal retirement age would be 68.1 years today, and the early retirement age would be 65.1 years. Because the retirement ages have not been indexed to longevity, beneficiaries have actually been receiving progressively larger total expected lifetime benefits since 1960, in part because they have been living more years on the program. Depending on one's perspective, keeping the benefit period steady rather than growing over time is, on the one hand, a benefit cut and, on another hand, simply a way of more closely maintaining the historical level of benefits.

[1] Cost rates are the ratio of the present value of tax income to the present value of taxable payroll for the years in a given period.

[2] Saving projections are expressed relative to the current system.

Table 1: Life Expectancy at Age 65

Year	Years of Remaining Life Expectancy
1960	14.3
1970	15.2
1980	16.4
1985	16.7
1990	17.2
1995	17.4

Source: U.S. Department of Health and Human Services, 1997

Finally, the prospect of raising the normal and/or early retirement age raises questions about the ability of some workers to continue employment until the eligibility agespecifically, workers with physically demanding occupations. While overall, research in this area is still in need of support and continuation before such effects can be adequately assessed, one ground-breaking study by Burkhauser, Couch, and Phillips (1995) was done using data from the Health and Retirement Survey (HRS).[3] They found that "the great majority of those who take early benefits have both good health and economic well-being." Contrary to popular conception, they found that only about 5 percent of those taking early retirement and 2 percent of those retiring at the normal retirement age reported a health limitation. These results suggest that an increase in the normal retirement and/or early retirement age would not force droves of workers in poor health to continue employment or to apply for Social Security disability benefits.

However, whether those workers who are in poor health later in life but who are too young to qualify for Social Security retirement benefits should be forced to rely on disability or welfare benefits for support is an important policy issue. Today, Social Security disability benefits are issued only through a complex determination process. As a society, we may decide that persons in their sixties should not be held to the same disability standards as younger persons. Burkhauser et al. (1995) suggest that older workers with health limitations may be particularly vulnerable to hardship in the face of an increased normal and/or early retirement age. Among those who reported a health limitation at early retirement age, Burkhauser et al. found that the incidence of poverty was high.

While certainly not an exhaustive list, the above three considerations are likely to be important to policymakers and the public alike in deciding whether to raise the normal retirement age. First, if delayed retirement is sought, an increase in the early retirement age rather than (or in addition to) the normal retirement age is a more likely impetus. Second, because of increases in life expectancy at age 65, a raise in the normal and/or early retirement age(s) may be perceived by policymakers and the public as a benefit cut or alternatively as simply a means of maintaining historical benefits. Finally, while it may be unlikely that a deluge of beneficiaries would flock to the disability and/or welfare rolls upon an increase in retirement age(s), present research suggests that some innovative policy provisions will likely need to be designed for those most vulnerable to adversity under such a policy reform.

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[3] For additional analysis on the HRS, see Fronstin (1997).

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Statement of Jonathan Barry Forman, University of Oklahoma

I am pleased to submit this statement for the record you are compiling on The Future of Social Security for this Generation and the Next. I am submitting this statement in my individual capacity as a Professor of Law at the University of Oklahoma College of Law where I teach courses on tax and pension law and research primarily about tax, pension, and Social Security policy. The purpose of this statement is to discuss how the current Social Security system discourages the elderly from working and to propose a solution to that problem. Specifically, I recommend creating individual retirement savings accounts (IRSAs)—but only for elderly workers. With IRSAs for elderly workers, those who chose to remain in the work force would no longer face the financial penalties of the current Social Security system. Consequently, more elderly workers would stay on the job, and that would enrich both them and the nation.[1]

PRIVATIZING SOCIAL SECURITY FOR ELDERLY WORKERS

Social Security is in financial trouble. The primary reason for this trouble is that workers are living longer and retiring earlier. Of course, it's great that we are living longer, and it's wonderful that we can expect to have long and leisurely retirements. But it has led to the current financing problem, and the federal government must soon either cut Social Security benefits or raise taxes.

In short, there are too many retirees and not enough workers to support them. The ratio of workers-to-beneficiaries has been declining for years. There were 16.5 workers for every beneficiary in 1950, but, by 2015—soon after the baby boomers start to retire—there will be just 2.7 workers per beneficiary.

Ironically, the current Social Security system actually compounds its own financial woes by pushing elderly workers into early retirement. A whole range of arcane rules discourage most everybody from working past age 62. Not surprisingly, more than half of all workers claim their Social Security benefits at age 62, and 72 percent of workers claim them by age 65.

On the bright side, however, it should be possible to improve Social Security's finances by encouraging the elderly to stay in the work force. Keeping elderly workers on the job would increase the worker-to-beneficiary ratio. That would bring down costs for both Social Security and Medicare, and the work efforts of these elderly workers would enrich them and the nation.

Demography and Destiny. The primary reason for Social Security's financial woes is that people are living longer but retiring earlier. For example, a boy born in 1940 had a life expectancy of just 61.4 years, but a boy born today can expect to live to 72. Similarly, a man reaching age 65 in 1940 could expect to live another 11.9 years, but a man reaching 65 today can expect to live another 15 years.

Yet despite the fact that life expectancies have gone up, there has been a marked trend towards earlier and earlier retirement. For example, the average age at which workers begin receiving Social Security has fallen from 68.8 years old for men in 1940 to 63.6 years in 1994. Also, in 1995, only 16.8 percent of men and 8.8 percent of women aged 65 or older were still working.

Social Security Discourages the Elderly From Working. The federal government has little reason to intrude on an individual's decision about when to retire. Nevertheless, the current Social Security system actively discourages the elderly from working.

Once a worker reaches age 62 and is eligible to receive Social Security, delaying the receipt of benefits can actually be quite costly. Those who delay retirement lose current benefits, but the increases in benefits that can result from an additional year of work rarely compensate for the benefits lost. In fact, since only 35 years of work count for determining a worker's Social Security benefit, each additional year of work after age 62 usually squeezes out the benefits earned in an earlier year.

[1] This statement is based on the author's forthcoming article: Jonathan Barry Forman, *Reforming Social Security to Encourage the Elderly to Work*, 9 Stanford Law and Policy Review—(forthcoming 1998).

Moreover, elderly workers must continue to pay Social Security taxes (and income taxes) on their earnings.

Individuals who start to draw Social Security benefits at age 62 but nevertheless keep working are particularly hard hit. The so-called retirement earnings test takes a dollar of Social Security benefits away for each dollar of earnings in excess of $9,120 this year. Also, in addition to paying the usual income and Social Security taxes on earned income, these workers may have to pay income tax on up to 85 percent of their Social Security benefits. The net effect is that many workers over the age of 62 can face confiscatory tax rates on their earned income.

Workers who wish to work past age 65 face yet another work disincentive. The delayed retirement credit increases the monthly benefit paid to a worker who postpones retirement past age 65 by just 5 percent for each year that a worker postpones claiming benefits. Unfortunately, a 5-percent credit is inadequate to compensate for a year of lost benefits. The delayed retirement credit will increase gradually to an actuarially fair 8 percent in the year 2008. Until then, however, Social Security indisputably discourages the elderly from working past age 65.

Finally, those who work until they drop leave nothing behind for their estates.

Faced with these work disincentives, it's no surprise that more than half of elderly workers retire as soon as they can—at age 62—and that fully 72 percent of elderly workers retire by age 65.

So what can be done to encourage the elderly to remain in the work force?

One approach would be to repeal the earnings test, raise the delayed retirement credit to 8 percent, and change the other arcane rules that discourage the elderly from working. And Congress might want to increase Social Security's early and normal retirement ages to, say, 65 and 70 respectively.

An alternative approach would be to privatize the Social Security system. Proponents of privatization typically call for replacing the current system with individual retirement savings accounts (IRSAs) that would operate pretty much like today's Individual Retirement Accounts (IRAs) and 401(k) plans. The Social Security taxes that workers now pay to the federal government would go instead into these IRSAs and be invested in the stock market.

Replacing all or a part of the current Social Security system with IRSAs would help encourage the elderly to work. Unlike the current Social Security system, payroll contributions and the earnings on those contributions would remain in individual accounts, and no money would ever be taken from one worker to provide benefits for other workers or their families. Consequently, there would be no penalty for working past age 62: IRSA contributions made by elderly workers would simply increase their own individual account balances.

Unfortunately, because there would be no redistribution under a privatized system, there would be no redistribution to those low-income retirees whose own individual account balances would provide inadequate retirement incomes. Consequently, unlike the current Social Security system, a privatized system could leave millions of elderly Americans in poverty.

Individual Social Security Accounts for Elderly Workers. A better approach would be to create individual retirement savings accounts—*but only for elderly workers*. As under current law, those workers who chose to retire immediately at age 62 could claim the usual Social Security benefits. For those workers who chose to work past age 62, however, an individual retirement savings account (IRSA) would automatically be opened. These accounts would be held by the government, invested in the stock market, and annuitized on retirement.

The starting balance in each worker's account would be the present value of that worker's Social Security benefit entitlement at age 62. For example, an average-wage single man who turned 62 and retired in 1997 could claim a Social Security benefit of $743 a month. Each year that benefit will be indexed for inflation, and it will continue until he dies. In effect, he is entitled to an indexed lifetime annuity with a starting payment of $743 per month. The starting balance for his IRSA would be an amount exactly equal to the present value of that annuity—about $116,000, according to the Social Security actuaries.

Each worker's IRSA would be invested in a secure equity fund and credited with investment earnings. Each IRSA would also be credited with any subsequent payroll contributions for that worker, and monthly statements would provide workers with information about their accounts.

Once an elderly worker decided to retire, the balance in that worker's account would be reconverted into an indexed lifetime annuity. These annuities would be a good deal larger than the benefits that were available at age 62. After all, the starting monthly payment for a worker who postponed retirement would be based upon the worker's then-higher account balance and then-shorter remaining life expectancy.

Moreover, the account balance of any elderly worker who died before retiring would be included in that worker's estate.

In short, individual Social Security accounts for the elderly would reward them for working past age 62. As a result, more elderly workers would stay on the job, and that would enrich both them and the nation.

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